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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

December 2016

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 5, 2016.

Following each paper is an identification of the staff who worked on a particular topic. If you should need additional information, please do not hesitate to contact the appropriate staff person.

I trust this information will be of assistance to members of the General Assembly.

Sincerely,

A handwritten signature in blue ink, appearing to read "Warren G. Deschenaux".

Warren G. Deschenaux
Executive Director

WGD/mpd

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Operating Budget

Economic and Revenue Outlook

Economic growth in Maryland accelerated in 2015 and 2016 with the State experiencing the biggest gains in employment since 2000. Wage income grew strongly in 2015 but decelerated in the first half of 2016 both in Maryland and nationally. General fund revenues in fiscal 2016 underperformed expectations, and the estimate for general fund revenues in fiscal 2017 was revised down.

Economic Outlook

The recession that began in December 2007 officially ended in June 2009 making the recovery phase of the business cycle seven years old. U.S. employment grew 2.1% in 2015, the biggest annual increase since 2000. Since bottoming out in February 2010, U.S. employment has increased by 15 million jobs, or 11.6%. U.S. personal income grew 4.4% in 2015 and wage income was up 5.1% for the second year in a row. Employment growth has slowed a bit in 2016 with jobs increasing by 1.8% through the first nine months of the year.

Since the recession ended, Maryland has generally underperformed relative to the nation as a whole. Employment growth in Maryland was below the U.S. growth in each year from 2011 to 2015. Maryland's recovery from the recession was derailed as the federal budget reductions of recent years along with the government shutdown in fall 2013 had a significant impact on the Maryland economy. Inflation-adjusted gross State product per capita fell in 2012 and 2013 and was up just 1.0% in 2014. Inflation-adjusted wage income per worker fell in Maryland for three years in a row (2011 to 2013) and grew 0.8% in 2014. Employment increased by less than 1.1% in both 2013 and 2014, and federal civilian employment in Maryland fell 1.2% in 2013 and 1.1% in 2014.

The Maryland economy rebounded in 2015 with a total employment growth of 1.5% and private-sector jobs up 1.9%. These increases, while slower than the U.S. growth, reflect the strongest employment growth in the State since 2005 for the total and since 2000 for the private sector. Total wages in Maryland grew 4.6% in 2015 and, because inflation was extraordinarily low, the real wage per worker was up 3.0%, the biggest increase since 1998. The data available for 2016 shows that employment growth has continued to accelerate, closing the gap with the U.S. growth. Maryland employment in the first nine months of 2016 was up 2.0%. Alternate measures of the labor market suggest that the monthly employment data is likely overstating growth and that the true increase is around 1.8%. This is still a significant acceleration from 2015 and the best total employment growth the State has experienced since 2000.

Despite the strong labor market, wage growth has weakened in 2016, both nationally and in Maryland. In the first half of 2016, Maryland wage income was up 3.5% and total personal income increased just 3.2%, a slowdown of about a percentage point from the 2015 growth. The

same pattern is evident at the national level with year-to-date personal income growth of 3.3%, down from 4.4% in 2015, and wage income growth of 3.9%, down from 5.1% in 2015.

In September 2016, the Board of Revenue Estimates (BRE) issued a revised economic forecast for Maryland, its first since December 2015 (**Exhibit 1**). BRE revised the economic outlook largely in line with recent performance. Employment growth for 2016 was revised up from 1.3% to 1.9%, but the forecast of employment in future years was unchanged. The projection for personal income growth in 2016 was lowered a full percentage point, from 4.7% to 3.7%, and reduced from 5.1% to 4.4% in 2017. The downward revision was due mostly to expected slower growth for wages and income from dividends, interest, and rent. Long-term employment growth decelerates as the working age population is projected to increase slowly and eventually decline as the baby boom cohort continues to move into retirement.

Exhibit 1
Maryland Economic Outlook
Year-over-year Percentage Change

<u>Calendar Year</u>	<u>Employment</u>		<u>Personal Income</u>	
	<u>Dec. 2015</u>	<u>Sep. 2016</u>	<u>Dec. 2015</u>	<u>Sep. 2016</u>
2013	0.9%	0.9%	-0.2%	-0.6%
2014	0.9%	0.9%	3.8%	3.4%
2015	1.5%	1.5%	4.2%	4.1%
2016E	1.3%	1.9%	4.6%	3.7%
2017E	1.0%	1.0%	5.1%	4.4%
2018E	0.8%	0.8%	4.5%	4.6%
2019E	0.5%	0.5%	4.2%	4.2%

Note: The figures for 2015 under the Dec. 2015 columns are estimates.

Source: Board of Revenue Estimates

Revenue Outlook

Fiscal 2016 general fund revenues were below the estimate by \$250 million, or 1.5%. General fund revenues totaled \$16.2 billion in fiscal 2016, an increase of 1.7% over fiscal 2015. Excluding the distribution of transfer tax revenue to the General Fund, which declined from \$144 million in fiscal 2015 to \$115 million in fiscal 2016, growth was 1.9%.

The underattainment of revenues was due almost entirely to the personal income tax. General fund personal income tax revenues were below the estimate by \$262.0 million in fiscal 2016 and grew 2.1% over fiscal 2015. Every component of gross receipts was below the

estimate while refunds came in substantially above estimate. Refunds grew 8.5% over fiscal 2015, the biggest increase since fiscal 2009. The corporate income tax exceeded the fiscal 2016 estimate by \$7.8 million and grew 12.5% over fiscal 2015. Corporate income tax revenues in fiscal 2016 included a large payment related to a court case. Adjusted for that one-time payment, growth in corporate income tax revenues in fiscal 2016 was around 8.0%. The sales tax, falling below the estimate by \$5.2 million, was up 2.2% over fiscal 2015. Fiscal 2016 revenues reflect the first full year of remittances from Amazon.com, which began collecting the sales tax on its sales in the State in October 2014.

Fiscal 2017 general fund revenue collections through September 2016 were up 6.0% from last year. Personal income tax revenues were up 11.5% in the first quarter of fiscal 2017 as withholding was up 8.4% over the prior year. Income tax gross receipts were up 10.8% while refunds fell 3.1% in the first three months of fiscal 2017. General fund corporate income tax revenues were down 12.4% despite a change in the distribution that lowered the amount going to the Transportation Trust Fund and increased the amount going to the General Fund. Corporate gross receipts were down 8.7% while refunds were up 29.5%. Sales tax general fund revenues were up just 1.6%, but gross receipts grew 3.0%. The General Fund does not receive any money from the vehicle rental tax in fiscal 2017, which depresses growth relative to the prior year.

In September 2016, BRE reduced its estimate for fiscal 2017 general fund revenues by \$365 million, or 2.1% (see **Exhibit 2**). The personal income tax estimate was revised down by \$307 million (-3.3%) reflecting the underattainment in fiscal 2016 but also the downward revision to personal income and capital gains income. The weaker economic outlook also contributed to a \$27 million reduction in the sales tax estimate. Despite overattainment in fiscal 2016, the corporate income tax estimate for fiscal 2017 was lowered by \$11 million (-1.3%) due to weaker national corporate profit forecasts. Total general fund revenues are projected to grow 2.7% in fiscal 2017 and 3.4% in fiscal 2018. Excluding the distribution of transfer tax revenue to the General Fund, revenues are projected to grow 3.0% in fiscal 2017 and 3.5% in fiscal 2018.

Exhibit 2
Maryland General Fund Revenue Forecast
(\$ in Millions)

	<u>Fiscal 2017</u>				<u>Fiscal 2018</u>	
	<u>BRE</u> <u>Mar. 2016</u>	<u>BRE</u> <u>Sep. 2016</u>	<u>\$ Diff.</u>	<u>% Change</u> <u>2017/2016</u>	<u>BRE</u> <u>Sep. 2016</u>	<u>% Change</u> <u>2018/2017</u>
Personal Income Tax	\$9,270	\$8,964	-\$307	5.2%	\$9,370	4.5%
Sales and Use Tax	4,601	4,575	-27	2.9%	4,725	3.3%
Corporate Income Tax	864	853	-11	-2.4%	898	5.3%
Lottery	520	513	-7	-3.2%	524	2.2%
Other	1,745	1,731	-14	-5.5%	1,687	-2.5%
Total	\$17,000	\$16,635	-\$365	2.7%	\$17,205	3.4%

BRE: Board of Revenue Estimates

Source: Board of Revenue Estimates

Operating Budget

Budget Outlook

The State budget outlook has worsened since the legislature enacted the fiscal 2017 budget in April 2016, primarily due to underattaining revenues. Actual fiscal 2016 general fund revenues were \$250 million less than projected. In September 2016, the Board of Revenue Estimates reduced the fiscal 2017 revenue projection by \$365 million. The Department of Legislative Services also has identified \$234 million in spending deficiencies. In response to the revenue shortfall, the Board of Public Works withdrew \$82 million in appropriations in November 2016. Current estimates expect fiscal 2017 to end with a \$196 million deficit, compared to a \$363 million surplus. In the out-years, ongoing spending increases at a 5% rate, and ongoing revenues increase at a 4% rate. Consequently, the structural deficit increases approximately \$200 million each year and peaks at the end of the forecast period at \$1,313 million.

Background

Fiscal 2016 closed with a general fund balance of \$384.5 million. General fund revenues totaled \$16.1 billion, an increase of 1.9% over fiscal 2015. **Exhibit 1** illustrates the changes by revenue component compared to the revised estimate from March 2016 adjusted for action at the 2016 session. Personal income taxes were lower than estimated by \$261.5 million. Although employment grew by 1.8%, the Board of Revenue Estimates (BRE) indicates that this is likely because many of the positions created paid lower wages than the statewide average. Sales and use taxes also decreased by \$5.2 million, partly due to the effects of low-wage growth, but also based on lower spending by an aging population, more spending on services, and the substitution effects of casino gambling. Slightly higher attainment was realized from corporate income taxes and the State Lottery, which surpassed the estimate by 0.9% and 1.8%, respectively.

Exhibit 1 Fiscal 2016 Estimated vs. Actual General Fund Revenue Performance (\$ in Millions)

	<u>Fiscal 2016 Estimated</u>	<u>Fiscal 2016 Actual</u>	<u>Change</u>
Personal Income Tax	\$8,779.1	\$8,517.6	-\$261.5
Sales and Use Tax	4,449.7	4,444.5	-5.2
Corporate Income Tax	866.6	874.5	7.8
State Lottery	520.4	529.8	9.4
Other	1,716.9	1,716.3	-0.6
Total	\$16,332.7	\$16,082.6	-\$250.1

Source: Department of Legislative Services

Fiscal 2017 Activity

Exhibit 2 shows that fiscal 2017 is projected to end with a negative general fund balance of -\$195.6 million, which is \$558.9 million below what was expected when the budget was enacted at the 2016 session. The turnaround is chiefly attributable to revenue under performance, as there was \$250.5 million in revenue underattainment associated with the fiscal 2016 closeout and a downward revision of \$365.1 million by BRE in September 2016.

Exhibit 2 Evolution of the Fiscal 2017 General Fund Balance (\$ in Millions)

	<u>Fiscal 2017</u>
Estimated Closing Balance (July 2016)	\$363.3
Revenue	
Fiscal 2016 Closeout	-\$250.5
September 2016 Board of Revenue Estimates Revenue Revision	-365.1
November 2016 Administration Assumptions	14.1
Transfers	
Net Change in Budgeted Tax Credits	13.2
Spending	
Fiscal 2016 Closeout Reversions	83.7
Targeted Fiscal 2017 Reversions	97.5
Revised DLS Estimated Fiscal 2017 Deficiencies	-234.2
November 2016 Board of Public Works Withdrawn Appropriations	82.3
Revised Closing Balance (November 2016)	-\$195.6

DLS: Department of Legislative Services

Source: Department of Legislative Services

Agencies underspent their fiscal 2016 appropriations by \$83.7 million. Savings identified at closeout came mostly from lower Medicaid enrollment, vacancies and delayed procurements in the Department of Public Safety and Correctional Services, overbudgeted Homeowner's tax credits, lease savings from the sale of State-owned video lottery terminals, and lower special education nonpublic placements.

Subsequent to the revenue revision, the Administration withdrew \$82.3 million in general fund appropriations through the Board of Public Works (BPW) on November 2, 2016. This included \$28.8 million in reductions that will be replaced by special fund balances (chiefly \$20.0 million in the Cigarette Restitution Fund balance that will replace a similar amount of general funds in Medicaid), \$19.6 million in various agency reductions, \$16.0 million from higher education, \$7.1 million from entitlements, \$7.0 million from housing pay-as-you-go (PAYGO) spending, and \$3.9 million in local aid. The Administration is also assuming additional revenue from a nationwide settlement with Volkswagen as well as reversions from the lottery due to special fund reductions adopted by BPW. Finally, the Administration has indicated that \$87.7 million from items restricted in the fiscal 2017 budget will not be spent for various legislative priorities but will instead be reverted. Another \$9.8 million in Maryland Department of the Environment PAYGO will also revert, with the intention of replacing those funds with general obligation bonds at the 2017 session.

Fiscal 2018 to 2022 Forecast

Exhibit 3 provides the Department of Legislative Services (DLS) general fund forecast through fiscal 2022. Relative to the forecast prepared following the 2016 session, the fiscal outlook has worsened. Due in part to an overestimation of personal income tax from capital gains, as well as slower than expected wage growth, BRE wrote down its revenue estimates in the out-years by more than \$500 million annually. Spending is also higher than projected. Medicaid enrollment is growing faster than expected, and rate increases for managed care organizations have added to spending. As a result, a structural shortfall of -\$339 million is projected for fiscal 2018. The Governor will also need to close a cash shortfall of nearly \$500 million when submitting a proposed budget at the 2017 session. This additional shortfall is due to statutory requirements for appropriations to the State Reserve Fund as well as mandated spending for the Department of Housing and Community Development PAYGO programs.

Driven largely by the BRE revenue write-down, the structural imbalance between ongoing general fund revenues and spending grows from -\$703 million in fiscal 2019 to -\$1.3 billion in fiscal 2022. In addition to Medicaid growth, DLS has estimated personnel expense growth related to annual 1% general salary increases, annual increments, and slightly higher health insurance growth. Finally, debt service also increases by more than \$300 million between fiscal 2018 and 2022 based on the amount of debt issued over the past several years.

Conclusion

Cash and structural shortfalls are projected in the current fiscal year, despite the withdrawal of \$82.3 million through BPW in November 2016. The Administration faces a greater challenge when submitting a fiscal 2018 spending plan in January 2017 at which time a cash shortfall of nearly \$500 million is estimated. DLS projects that structural shortfalls could exceed \$1.3 billion by fiscal 2022. A significant revenue write-down, coupled with spending growth in the Medicaid program and formula mandates, have combined to worsen the State's fiscal outlook. A multiyear approach will likely need to be adopted, including both revenue and spending actions.

Exhibit 3
General Fund Projections
Fiscal 2017-2022
(\$ in Millions)

	<u>Working 2017</u>	<u>Baseline 2018</u>	<u>Estimate 2019</u>	<u>Estimate 2020</u>	<u>Estimate 2021</u>	<u>Estimate 2022</u>	<u>Avg. Annual Change 2018-2022</u>
Revenues							
Opening Fund Balance	\$385	\$0	\$0	\$0	\$0	\$0	
Transfers	0	0	0	0	0	0	
One-time Revenues/Legislation	14	0	0	0	0	0	
Subtotal One-time Revenue	\$399	\$0	\$0	\$0	\$0	\$0	
Ongoing Revenues	\$16,665	\$17,237	\$17,855	\$18,515	\$19,211	\$19,947	
Subtotal Ongoing Revenue	\$16,665	\$17,237	\$17,855	\$18,515	\$19,211	\$19,947	3.7%
Total Revenues and Fund Balance	\$17,051	\$17,237	\$17,855	\$18,515	\$19,211	\$19,947	3.7%
Ongoing Spending							
Operating Spending	\$17,490	\$18,103	\$19,088	\$19,995	\$20,946	\$21,830	
Education Trust Fund*	-463	-566	-554	-562	-570	-579	
Multiyear Commitments	9	39	24	14	14	9	
Subtotal Ongoing Spending	\$17,074	\$17,576	\$18,558	\$19,447	\$20,389	\$21,260	4.9%
One-time Spending							
PAYGO Capital	\$53	\$47	\$93	\$67	\$93	\$21	
Legislation/One-time Adjustments/Swaps	-66	0	0	0	0	0	
Appropriation to Reserve Fund	235	100	50	50	83	83	
Subtotal One-time Spending	\$223	\$147	\$143	\$117	\$176	\$104	
Total Spending	\$17,259	\$17,723	\$18,701	\$19,564	\$20,565	\$21,364	4.8%
Ending Balance	-\$195	-\$486	-\$846	-\$1,050	-\$1,354	-\$1,417	
Rainy Day Fund Balance	\$998	\$1,059	\$1,120	\$1,187	\$1,256	\$1,333	
Balance Over 5% of General Fund Revenues	165	197	227	262	296	335	
As % of General Fund Revenues	5.99%	6.14%	6.27%	6.41%	6.54%	6.68%	
Structural Balance	-\$371	-\$339	-\$703	-\$933	-\$1,179	-\$1,313	

PAYGO: pay-as-you-go

*The Education Trust Fund is supported by revenues from video lottery terminals and table games.

Source: Department of Legislative Services

Operating Budget

Transportation Trust Fund Overview

The Transportation Trust Fund closed fiscal 2016 with a fund balance \$1 million higher than the \$125 million projected ending balance. The Department of Legislative Services assumes lower total revenue attainment and higher operating expenses than estimated by the Maryland Department of Transportation over the fiscal 2017 to 2022 forecast period. This will reduce the six-year capital program by \$1.7 billion.

Fiscal 2016 Closeout

The Transportation Trust Fund (TTF) ended fiscal 2016 with a fund balance \$1 million higher than the \$125 million projected ending balance. Revenues were \$77 million lower than projected, and expenditures were \$78 million lower than projected.

Nonbond-related revenues exceeded projections by \$48 million. Motor fuel tax revenue was \$28 million lower than projected, but other revenues were up by a combined \$76 million. Bond sales were \$150 million below projections, reflecting reduced cash flow needs and receipt of \$25 million in bond premiums.

On the expenditure side of the equation, spending was a net \$78 million less than estimated. Increases related to winter maintenance and other department operations were offset by decreased capital spending due to project cash flow needs, reduced highway system preservation funding to cover winter maintenance costs, and decreased special fund spending on the Purple Line due to spending federal funds first and delayed spending due to legal challenges.

Fiscal 2017 to 2022 TTF Forecast

Exhibit 1 shows the fiscal 2017 to 2022 TTF forecast by the Department of Legislative Services (DLS). The forecast details the expected trends in revenue attainment, debt issuance, and expenditures. Compared to the Maryland Department of Transportation (MDOT) forecast, DLS assumes revenue attainment that is \$267 million lower and operating budget spending that is \$588 million higher. The lower revenue and higher spending assumptions require a reduction in bond issuances over the forecast period totaling \$987 million in order to maintain minimum debt service coverage ratios. Based on DLS estimates, the six-year capital program would be \$1.7 billion less than projected in the MDOT forecast.

Exhibit 1
Transportation Trust Fund Forecast
Fiscal 2017-2022
(\$ in Millions)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Total 2017-22</u>
Opening Fund Balance	\$126	\$125	\$125	\$150	\$150	\$150	\$150
Closing Fund Balance	\$125	\$125	\$150	\$150	\$150	\$150	\$150
Net Revenues							
Taxes and Fees	\$2,553	\$2,601	\$2,693	\$2,750	\$2,821	\$2,890	\$16,308
Operating and Miscellaneous	644	634	642	626	668	676	3,890
Subtotal	\$3,197	\$3,235	\$3,335	\$3,376	\$3,489	\$3,566	\$20,198
Bond Proceeds	845	585	452	296	240	260	2,678
Fund Balance (Increase)/Use	1	0	-25	0	0	0	-24
Total Net Revenues	\$4,043	\$3,820	\$3,762	\$3,672	\$3,729	\$3,826	\$22,852
Expenditures							
Debt Service	\$307	\$340	\$332	\$353	\$405	\$434	\$2,171
Operating Budget	1,940	2,021	2,124	2,232	2,345	2,464	13,127
State Capital	1,796	1,459	1,305	1,088	978	928	7,554
Total Expenditures	\$4,043	\$3,820	\$3,762	\$3,672	\$3,729	\$3,826	\$22,852
Debt							
Debt Outstanding	\$2,718	\$3,082	\$3,334	\$3,415	\$3,389	\$3,351	
Debt Coverage – Net Income	3.6	3.3	2.9	2.7	2.5	2.5	
Local Highway User Revenue	\$175	\$176	\$179	\$181	\$184	\$186	\$1,080
Capital Summary							
State Capital	\$1,796	\$1,459	\$1,305	\$1,088	\$978	\$928	\$7,554
Net Federal Capital (Cash Flow)	1,053	948	829	756	729	653	4,968
Total Capital Expenditures	\$2,849	\$2,407	\$2,134	\$1,844	\$1,707	\$1,581	\$12,522
GARVEE Debt Service	\$87	\$87	\$87	\$51	\$0	\$0	\$314

GARVEE: Grant Anticipation Revenue Vehicle

Source: Department of Legislative Services

Revenues

Over the six-year forecast, DLS estimates that tax and fee revenue will total \$20.2 billion with an average annual growth rate of just 2.2%. This weak growth rate results from projected annual growth in motor fuel usage of less than one-quarter of 1.0% during the forecast period combined with low rates of inflation and gas price increases of just over 50 cents over the six-year period.

Operating and Debt Service Expenditures

Operating and debt service expenditures are the first draw on TTF revenues. Over the six-year period, operating expenses are estimated to total \$13.1 billion, and debt service expenditures are estimated to total \$2.2 billion. The DLS baseline budget estimate for MDOT operations in fiscal 2018 is \$2.0 billion (4.2%) more than the current year working appropriation. The DLS forecast projects operating expenses to grow at an average annual rate of 5.1% from fiscal 2019 to 2022 – the five-year average annual rate experienced by MDOT through fiscal 2016, the most recent year for which actual expenditures are available. This results in an average annual increase of 4.9% for the entire fiscal 2017 to 2022 forecast period. Compared to the MDOT forecast, the DLS estimate of debt service is \$180 million lower over the forecast period as a result of a lower level of bond issuance.

Debt Financing

Debt issued by MDOT supports the capital program. Debt issuances are limited by a total debt outstanding cap of \$4.5 billion and two coverage tests that require the prior year's pledged taxes and net income to be at least two times greater than the maximum debt service for all bonds outstanding in the current fiscal year. The lower revenue attainment and higher operating spending discussed earlier results in the need to reduce the amount of bonds issued over the forecast period from the \$3.7 billion contained in the MDOT forecast by \$987 million. Absent this reduction in bond issuances, the net income debt service coverage ratio would fall to 2.3 in fiscal 2020, then decline to 2.2 in fiscal 2021, and 2.1 in fiscal 2022.

Capital Expenditures

DLS estimates that the total special and federal fund capital budget will total \$12.5 billion, almost \$1.7 billion less than MDOT's estimate contained in the draft 2017 to 2022 *Consolidated Transportation Program*.

Local Transportation Aid

The MDOT TTF forecast continues to reserve funds to phase in an increase in highway user revenues (HUR) provided to county and municipal governments. Over the forecast period, a total of \$761 million is set aside in the MDOT forecast. Should legislation be enacted increasing

the share of HUR going to local governments, the revenues available to support debt service would be decreased and result in the need to further reduce bond issuances in order to maintain minimum coverage levels. If the additional funds are provided as capital grants, however, there would be no impact on the debt service coverage ratios as the funds would first accrue to the TTF and be allocated through the capital program.

Operating Budget

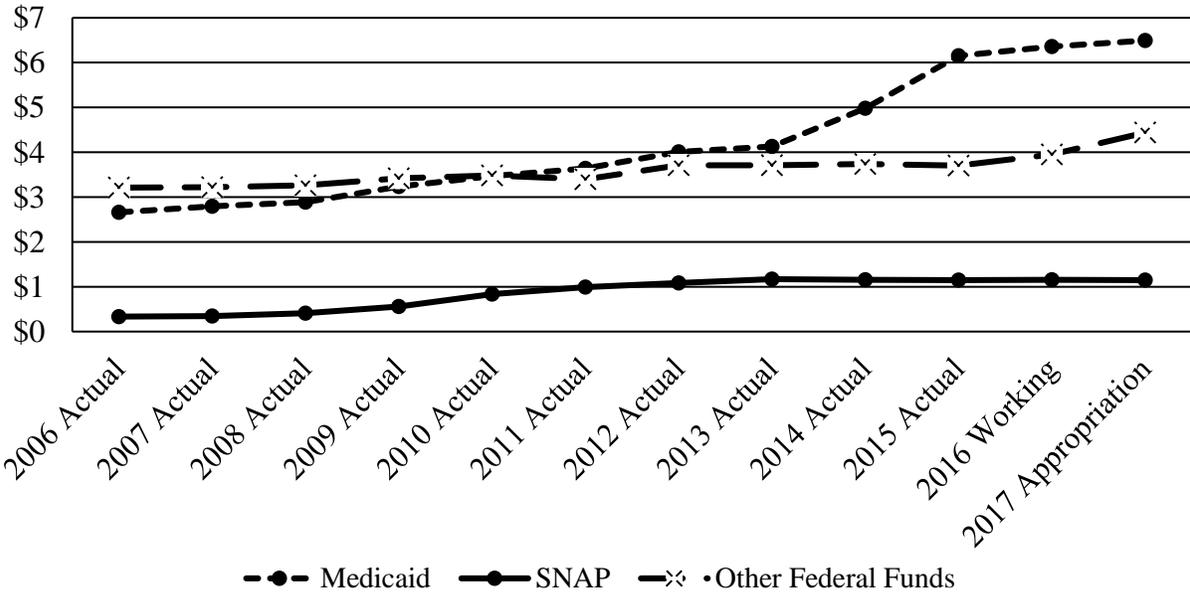
Federal Funds Outlook

In fiscal 2017, the State of Maryland anticipates \$12.1 billion in federal funds. The federal fiscal 2017 budget is funded with a continuing resolution that expires on December 9, 2016.

Federal Funds to the State of Maryland

Federal funds to the State have grown at a 6.6% annual rate since fiscal 2007; the fiscal 2017 federal fund appropriation totals \$12.1 billion. As shown in **Exhibit 1**, Medicaid accounts for \$6.5 billion in fiscal 2017, or 53.8% of total federal funds. Increases in Medicaid since fiscal 2007 are primarily due to enrollment growth during the recession. Starting in fiscal 2014, Medicaid funding increased dramatically as a result of the Affordable Care Act (ACA) expansion.

Exhibit 1
Medicaid, Supplemental Nutrition Assistance Program,
and Other Federal Funds
Fiscal 2007-2017
(\$ in Billions)



SNAP: Supplemental Nutrition Assistance Program

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

Fiscal 2017 Federal Fund Appropriation

Exhibit 2 shows the distribution of the fiscal 2017 federal fund appropriation by department/service area. Only \$23.2 million in federal funds from the American Recovery and Reinvestment Act of 2009 (ARRA) remain as ARRA funds expire.

Exhibit 2 Federal Funds in Fiscal 2017 Appropriation (\$ in Millions)

<u>Department/Service Area</u>	<u>Fiscal 2017 Appropriation</u>
Judicial Review and Legal	\$4.3
Executive and Administrative Control	220.6
Budgetary and Personnel Administration	9.2
General Services	1.3
Transportation	1,183.5
Department of Natural Resources	36.8
Agriculture	3.6
Health and Mental Hygiene	7,020.6
Human Resources	1,840.0
Labor, Licensing, and Regulation	195.4
Public Safety and Correctional Services	33.0
Public Education	1,178.7
Housing and Community Development	261.6
Commerce*	9.5
Environment	77.8
Juvenile Services	4.8
State Police	9.7
Public Debt	11.5
Total Federal Funds	\$12,102.0

*The Department of Commerce was formerly known as the Department of Business and Economic Development.

Note: Numbers may not sum due to rounding. Federal fund total includes \$23.2 million in American Recovery and Reinvestment Act of 2009 funds.

Source: Department of Budget and Management; Catalog of Federal Domestic Assistance

Federal Fiscal 2017 Budget Update

The Budget Control Act (BCA) of 2011 instituted limits on discretionary spending from federal fiscal year (FFY) 2012 through 2021. The failure of the Joint Select Committee on Deficit Reduction and Congress to enact deficit reduction legislation triggered reductions to discretionary spending in addition to \$1 trillion in reductions below the discretionary baseline enacted in the BCA; these across-the-board cuts are known as “sequestration.” Congress restored part of the scheduled reductions in FFY 2014 and 2015 with the Bipartisan Budget Act (BBA) of 2013 and in FFY 2016 and 2017 with BBA of 2015. Each of these restorations were paid for by other provisions that reduced the deficit, such as extending sequestration for nonexempt mandatory spending through FFY 2025.

As released on February 9, 2016, the FFY 2017 budget adheres to the defense and nondefense discretionary spending caps for FFY 2017, as revised by BBA of 2015. The legislation also includes new mandatory spending proposals and would eliminate sequestration of nonexempt mandatory programs. The Center for Responsible Federal Budget estimates that the budget would reduce deficits by \$2.9 trillion in FFY 2026. Under the proposed budget, funding would increase by 1.4% for major discretionary programs, 6.6% for mandatory programs, and 5.1% overall. Congress has yet to enact a FFY 2017 budget.

As a result of the pending FFY 2017 budget, Congress approved a continuing resolution (CR) on September 29, 2016, to keep the federal government operating through December 9, 2016. The CR is part of a package that includes \$1.1 billion in supplemental funding for Zika response efforts and a full-year appropriation for Military Construction-Veterans Affairs; this is the first time since FFY 2009 that a regular appropriation bill has been passed prior to the end of the fiscal year. Absent further legislation, discretionary spending limits scheduled for FFY 2018 through 2021 will return to levels instituted by BCA of 2011, and those limits will be enforced by sequestration if enacted appropriations exceed the limits.

Operating Budget

Impact of Pension Costs on the State Budget

State pension costs are a significant long-term liability. Costs have increased substantially in recent years. Efforts have been made to reduce the rate of growth, including enacting pension reforms and requiring local governments to share costs. The growth rate has slowed as these reforms take hold.

The State provides defined benefit pension plans. These plans require the State to make annual payments that represent the normal cost (the cost of the annual increase in benefits earned by employees) and a share of the unfunded liability. These pension payments are made to employees for years after they retire and represent a long-term liability to the State.

The State employees, judges, State Police, and Law Enforcement Officers pension funds are funded in agency budgets, and are primarily supported by the General Fund. Positions supported by special funds (such as the Maryland Department of Transportation) and federal funds (such as the Department of Health and Mental Hygiene) support pension costs with those funds. Fiscal 2017 appropriations total \$786 million, of which \$486 million are supported by the General Fund, and \$255 million are supported by higher education funds.

About 97% of the teachers' pension fund supports the staff of the local school boards. By statute, the local school boards pay the normal costs (the annual increase in the pension liability), and the State is responsible for any remaining costs (the unfunded liability). In fiscal 2017, pension contributions totaled \$1.105 billion, of which \$280 million is the normal cost paid by local school boards, and the remainder is almost entirely general funds.

Pension Costs Have Increased in Recent Years

State pension costs have increased in recent years. The primary reason for the increased costs are market losses suffered in fiscal 2008 and 2009 when the pension fund lost 5.4% and 20.0%, respectively. This reduced the funded ratio from 80.4% at the beginning of fiscal 2008 to 65.0% at the end of fiscal 2009. To reduce the unfunded liability, higher appropriations are necessary from the State. The amount that the State appropriates each year is determined by the actuarial funding method. It is State policy for the Governor to propose, and the General Assembly to appropriate, the amount certified by the State Retirement and Pension System Board. Total pension contributions increased from \$1.0 billion in fiscal 2010 to \$1.6 billion in fiscal 2017.

Pension Costs Contained in Response to Increasing Liabilities

In response to increasing liabilities, the State has made efforts to slow the cost growth by reducing benefits, increasing contributions, and requiring local jurisdictions to share in the costs of teacher pensions.

The most significant pension reform was enacted in 2011. Key provisions include:

- reducing cost-of-living adjustments earned after fiscal 2011;
- increasing employee contributions from 5.0% to 7.0% for most employees (judges, for example, were excluded);
- increasing the vesting period for employees hired after June 30, 2011, from 5 years to 10 years;
- reducing the multiplier for employees hired after June 30, 2011, to 1.5% or salary per year worked¹; and
- appropriating a share of savings to overfund pension contributions.

The State also required local governments to begin sharing costs in fiscal 2013. The actuarial approach was also modified beginning in fiscal 2017 as the State phases out the corridor method and adopts an actuarial approach. Taken together, these reforms reduce the State's out-year liabilities.

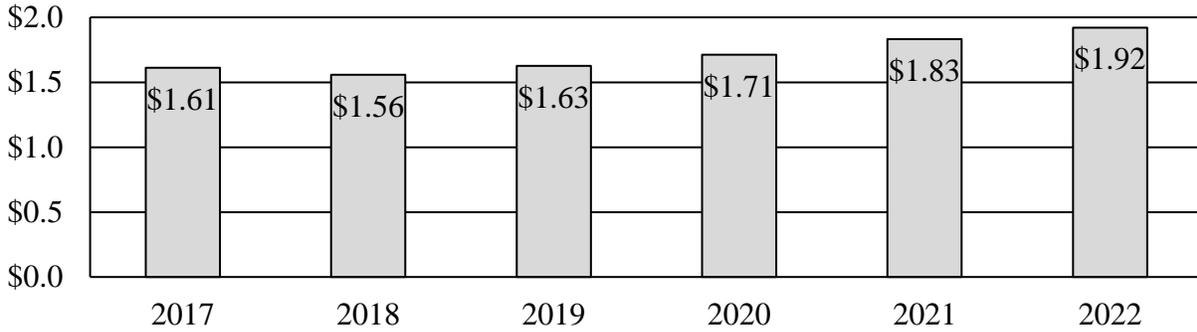
Pension Cost Outlook

Exhibit 1 shows that total pension costs are expected to increase from \$1.6 billion in fiscal 2017 to \$1.9 billion in fiscal 2022. This is an annual increase of 3.6%.

Exhibit 2 shows that general fund costs for pensions are approximately 8% of general fund revenues in the out-years. Increases in pension costs have slowed, in part due to pension reforms. The actuarial contribution rate for teachers' pensions declines in fiscal 2018. This is largely attributable to the higher turnover rate in the school systems, which has resulted in a higher percentage of less costly new teachers more quickly than the State employee system.

¹ The multiplier remains at 1.8% per year worked for employees hired before June 30, 2011.

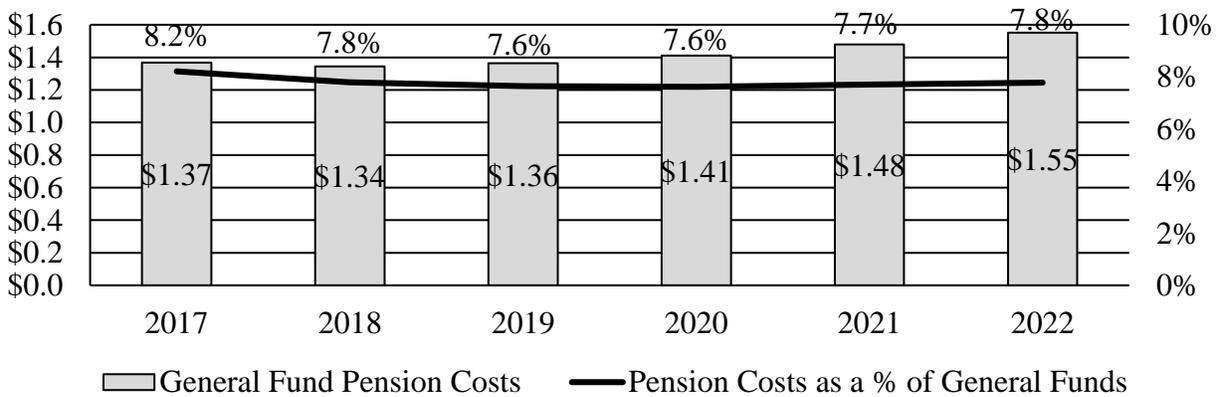
**Exhibit 1
Total State Pension Costs
Fiscal 2017-2022
(\$ in Billions)**



Note: State pension contribution excludes local teacher pension cost sharing and other local contributions.

Source: Gabriel Roeder Smith and Company; Department of Legislative Services, October 2016

**Exhibit 2
General Fund Pension Costs
As a Percentage of General Fund Revenues
Fiscal 2017-2022
(\$ in Billions)**



Note: State pension contribution excludes local teacher pension cost sharing and higher education institutions.

Source: Gabriel Roeder Smith and Company; Department of Legislative Services, October 2016

Operating Budget

Impact of General Obligation Debt Service Costs on the State Budget

General obligation (GO) bond debt service is a significant long-term liability. Costs have increased substantially in recent years. Efforts have been made to reduce the rate of growth. Since the Great Recession, the State has slowed the increase in new bond authorizations. Additionally, the current Administration is keeping GO bond authorizations at a flat \$995 million annually.

State capital construction projects are supported by various bonds, including general obligation (GO), transportation, stadium authority, and bay restoration. These bonds are long-term liabilities that require debt service payments for up to 15 years.

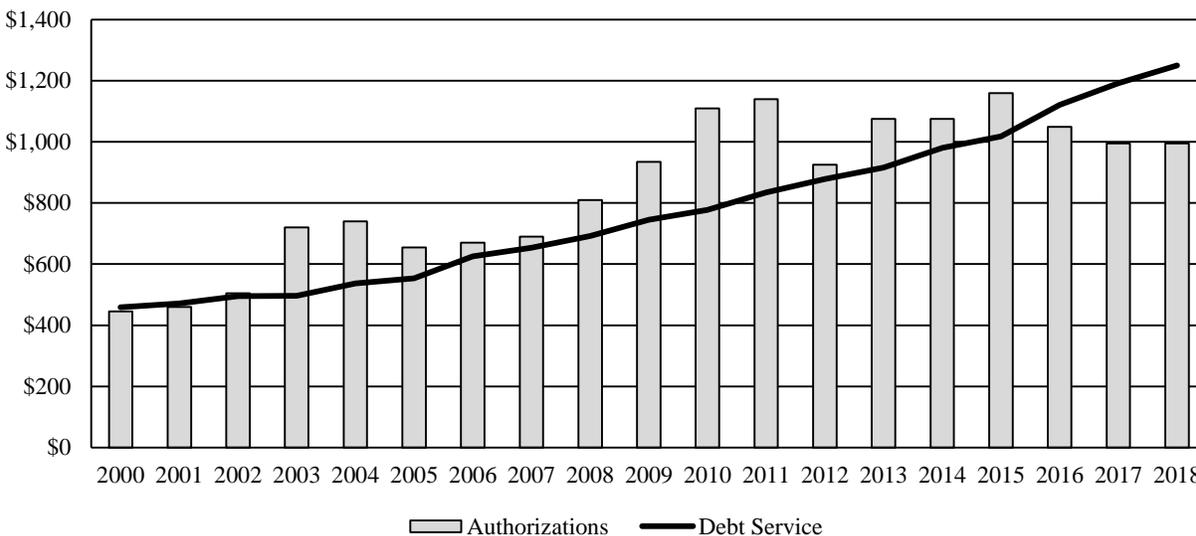
Debt Service Costs Influenced by Bond Authorization Policies

In the last 20 years, the State debt authorization policies have changed. State debt policies have shifted between slow growth, aggressive expansion, managing to the limit, and austerity; specifically:

- fiscal 1995 to 2000 was a period of slow growth as GO bond authorizations increased at a moderate rate of \$15 million per year;
- the GO program expanded substantially from fiscal 2001 to 2009, which was a period in which the State increased authorizations in excess of what was previously planned in all but one year;
- in response to reaching the 8% debt service to revenues limit (see the issue paper *Debt Affordability* for details) in December 2009, the State began to manage debt to remain within affordability limits through fiscal 2016; and
- a period of austerity began in fiscal 2017 as State policy shifted to maintain GO bond authorizations at \$995 million.

Increased GO bond authorizations after fiscal 2000 have resulted in increased debt service costs. **Exhibit 1** shows that debt service costs have increased from \$459 million in fiscal 2000 to \$1.250 billion in fiscal 2018. Over the same period, GO debt outstanding has increased from \$3.349 billion to \$9.469 billion.

Exhibit 1
Changes in General Obligation Bond Authorizations and Debt Service Costs
Fiscal 2000-2018
(\$ in Millions)



Source: Department of Legislative Services, October 2016

The exhibit also shows the lag between authorizations and debt service. Because only about one-third of authorized bonds are issued in the first year and because the State does not make principal payments until the third year, debt service cost increases lag increases in authorizations. The same is true when authorizations are decreased. In spite of reducing the capital program from \$1.160 billion in fiscal 2015 to \$995.0 million in fiscal 2017, debt service costs continue to increase. However, this austerity is expected to slow the increase in debt service costs in the out-years.

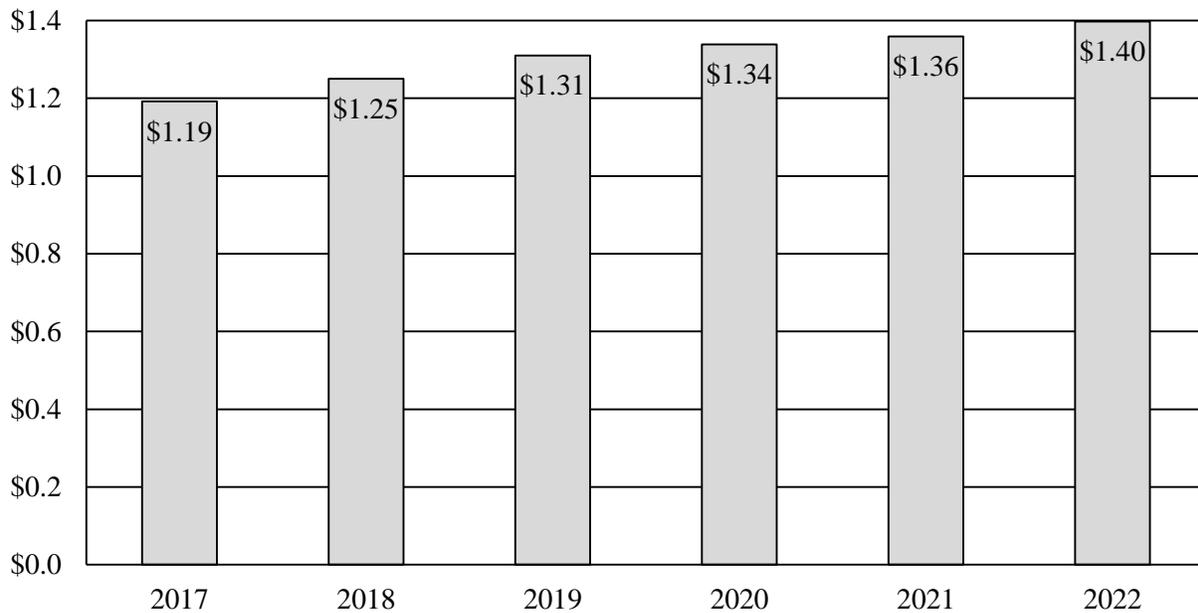
General Fund Support for Debt Service

Debt service and pensions are both supported by the General Fund. GO bond debt service costs are supported by the Annuity Bond Fund (ABF). The fund's largest revenue sources include State property tax revenues and proceeds from bond sale premiums. Other revenue sources include 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. Debt service costs have increased to the point that, unless the State raises property tax rates, general fund subsidies are necessary. General fund appropriations are \$283 million in fiscal 2017, and total debt service costs are \$1.192 billion.

Debt Service Cost Outlook

Exhibit 2 shows that total debt service costs are expected to increase from \$1.2 billion in fiscal 2017 to \$1.4 billion in fiscal 2022. This is an annual increase of 3.2%.

Exhibit 2
Combined Debt Service Costs
Fiscal 2017-2022
(\$ in Billions)

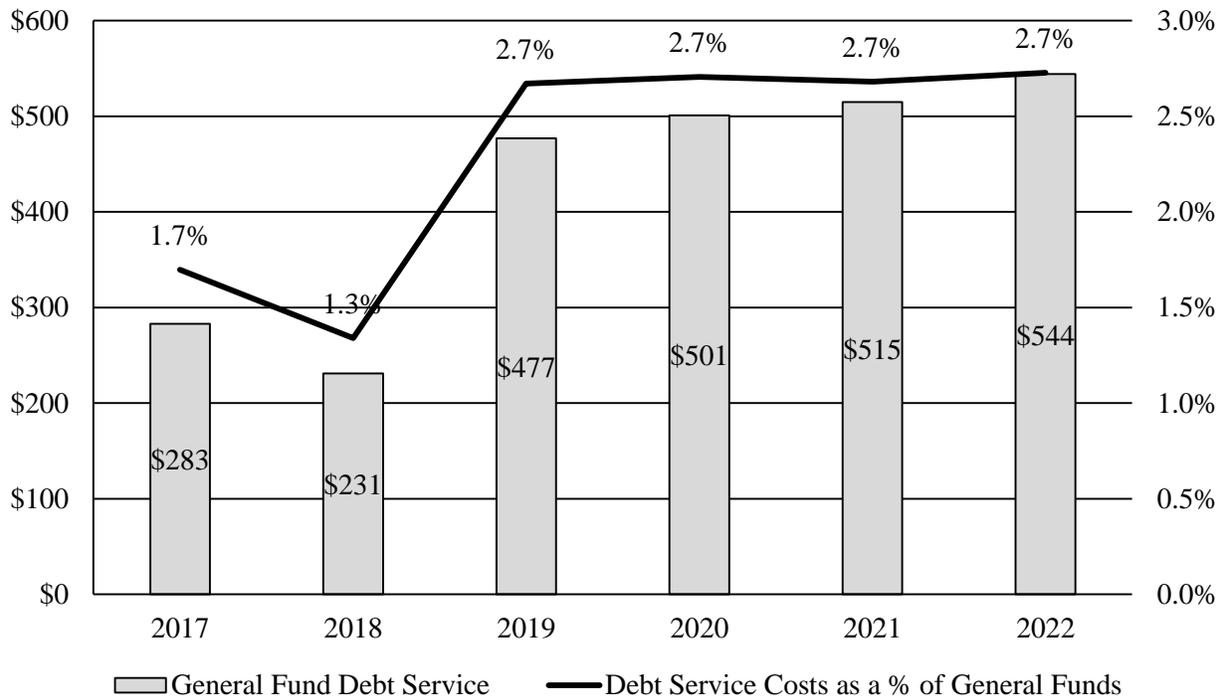


Note: Total State debt service includes transportation, bay restoration, capital leases, and stadium authority debt. State pension contribution excludes local teacher pension cost sharing and other local contributions.

Source: State Treasurer’s Office; Department of Legislative Services, October 2016

Exhibit 3 shows that general fund costs for debt service will be 2.7% of general fund revenues beginning in fiscal 2019. The decline in fiscal 2018 general fund debt service appropriations is attributable to unexpected premiums in fiscal 2017 and 2018 that reduce the need for general funds. Beginning in fiscal 2019, the forecast assumes only small premiums, so the State will need to appropriate approximately \$500 million annually in general funds to avoid increasing State property taxes above the current rate, which is \$0.112 per \$100 of assessable base.

Exhibit 3
General Fund Debt Service Costs
As a Percentage of General Fund Revenues
Fiscal 2017-2022
(\$ in Billions)



Source: State Treasurer’s Office; Department of Legislative Services, October 2016

Capital Budget

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling \$995 million for fiscal 2018. This level of capital spending keeps debt service payments below 8% of revenues and debt outstanding below 4% of personal income through the capital planning period that ends in fiscal 2022. The Treasurer's Office estimates that total tax-supported outstanding debt will be \$13.8 billion at the end of fiscal 2018, while debt service will be \$1.8 billion in fiscal 2018.

Capital Debt Affordability Process

State law requires the Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt to ensure that the State's tax-supported debt burden remains affordable. The committee is chaired by the State Treasurer and includes the State Comptroller, the Secretary of Transportation, the Secretary of Budget and Management, and a public member. The chairs of the Capital Budget subcommittees for the Senate Budget and Taxation Committee and the House Appropriations Committee are nonvoting members.

Tax-supported debt consists of tax-exempt and taxable general obligation (GO) debt, transportation debt, Grant Anticipation Revenue Vehicles (GARVEE), bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes. The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new GO and academic revenue debt for each fiscal year.

CDAC began evaluating State debt in 1979. In consultation with rating agencies, investment bankers, and its financial advisor, CDAC has adopted policies to limit State debt outstanding to 4% of personal income and State debt service to 8% of State revenues.

Affordability Ratios

Exhibit 1 shows CDAC's State debt affordability analysis. Debt service to revenues peaks in fiscal 2022 at 7.95%, and debt outstanding to personal income peaks in fiscal 2018 at 3.61%.

GO bonds support the State's capital program, which supports local public school construction, higher education, State facilities, and other capital projects. CDAC recommended that fiscal 2018 GO bond authorizations be limited to \$995 million. The State Treasurer's Office expects to issue another \$568 million in winter 2017. Total GO debt is projected to be \$9.25 billion at the end of fiscal 2018. GO bond debt service payments are projected to total \$1.25 billion in fiscal 2018.

Exhibit 1
Affordability Ratios
Fiscal 2017-2022

<u>Fiscal Year</u>	<u>Projected Debt Outstanding As a Percent of Personal Income</u>	<u>Projected Debt Service As a Percent of Revenues</u>
2017	3.54%	7.58%
2018	3.61%	7.81%
2019	3.59%	7.89%
2020	3.50%	7.82%
2021	3.40%	7.84%
2022	3.30%	7.95%

Source: State Treasurer's Office, October 2016

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from the Transportation Trust Fund, which is supported by motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other Maryland Department of Transportation (MDOT) revenues. State law limits Consolidated Transportation Bonds outstanding to \$4.5 billion. CDAC projects that total outstanding transportation debt will reach \$2.8 billion in fiscal 2018. Transportation bond debt service is projected to be \$310 million in fiscal 2018.

The department also issued GARVEE bonds in fiscal 2008 and 2009. These bonds are supported by federal transportation grants to the State. Chapters 471 and 472 of 2005 limit the total amount of GARVEEs that may be issued at \$750 million. The State pledges anticipated federal revenues to support the GARVEE debt service, and the statute specifies that the bonds are considered tax-supported debt. GARVEE debt outstanding is projected to be \$130 million at the end of fiscal 2018. GARVEE debt service costs are estimated to be \$87 million. These bonds mature in fiscal 2020. At this time, there are no plans to issue additional GARVEE bonds.

The Bay Restoration Fund was created by Chapter 428 of 2004 to provide grants for enhanced nutrient removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. To date, \$330 million has been issued. The Maryland Department of the Environment indicates that the final \$100 million will be issued in March or April 2017. The department estimates that \$374 million in bonds will be outstanding at the end of fiscal 2018. Debt service costs are projected to be \$36 million in fiscal 2018.

Capital leases for real property and equipment are also considered State debt if the revenues supporting the debt are State tax revenues. Examples of capital leases include the MDOT Headquarters Office Building and the Prince George's County Justice Center. Debt outstanding for leases is expected to be \$201 million at the end of fiscal 2018. Capital lease payments are estimated to be \$28 million in fiscal 2018.

The final category of State debt is Stadium Authority debt. Some Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County Conference Center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be \$86 million at the end of fiscal 2018. Debt service payments are projected to be \$25 million in fiscal 2018. The Maryland Stadium Authority does not plan to issue any State supported debt through fiscal 2018.

The University System of Maryland (USM), Morgan State University, and St. Mary's College of Maryland have the authority to issue debt for academic facilities, as well as auxiliary facilities. Unlike the other authorizations, Academic Revenue Bonds are not considered to be State debt; instead, they are a debt of the institutions. Proceeds from academic debt issued are used for facilities that have an education-related function, such as classrooms. Debt service for these bonds is paid with tuition and fee revenues. For fiscal 2018, CDAC recommends \$32 million for academic facilities on USM campuses.

Capital Budget

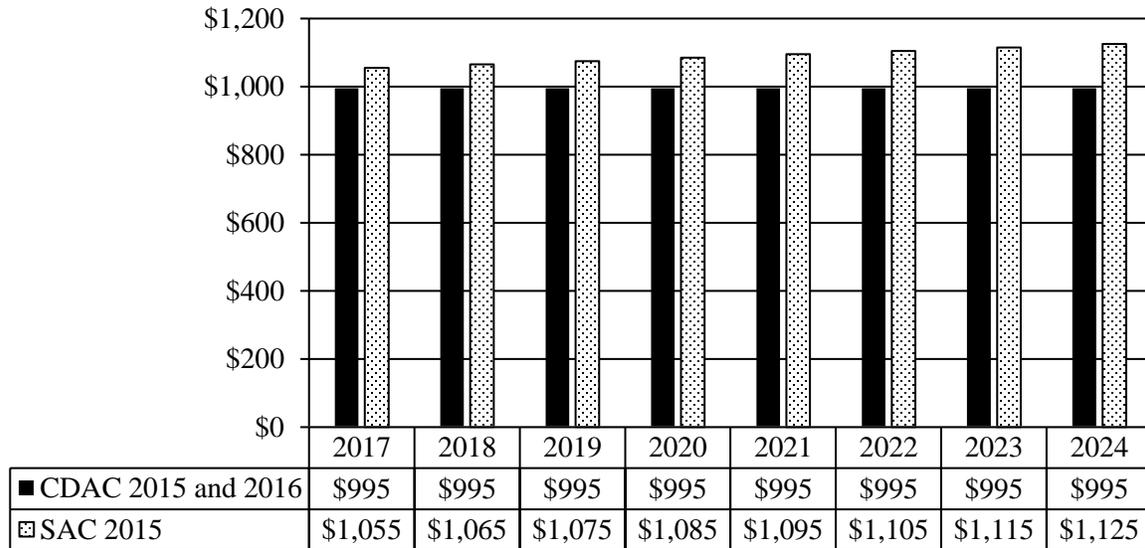
Capital Budget Outlook

On October 1, 2016, the Capital Debt Affordability Committee (CDAC) recommended limiting proposed new general obligation (GO) bond authorization levels to \$995 million for the 2017 session. CDAC's recommendation continues the policy established by the committee in its 2015 report of limiting authorization levels to \$995 million for each year in the planning period, which eliminates the inflationary increase that more recent recommendations provided. Without an inflationary adjustment, future GO bond authorization levels will be reduced by the impact of construction inflation on commodities and labor and will not keep pace with commitments made by the Administration and General Assembly in the 2016 session.

The Capital Debt Affordability Committee (CDAC) voted to keep the amount of new general obligation (GO) bond authorizations for the 2017 session at \$995 million, the same amount recommended by the committee for the 2016 session. The committee further recommended that the State limit for new GO bond authorizations remain at \$995 million annually through the planning period, which is also the same recommendation made by the committee in its 2015 report.

Exhibit 1 illustrates recent CDAC recommended GO bond authorization levels and the level recommended by the 2015 Spending Affordability Committee (SAC). The October 2016 CDAC recommendation continues the policy of scaled back future bond issuances to reduce annual debt service requirements, which are estimated to require increasing levels of general fund support. The 2015 SAC recommendation, recognizing the need to address the increasing reliance on general funds for debt service, established a limit on new GO bond authorizations that increased by 1% on a year-over-year basis. This moderate growth rate limits increases in GO bond authorizations to projected State property tax revenue increases. Since general funds and other State revenues are projected to increase at an annual rate in excess of 1%, this reduces the ratio of debt service to revenues in the out-years.

Exhibit 1
Effect of New Policy on General Obligation Bond Authorizations
Fiscal 2017-2024
(\$ in Millions)



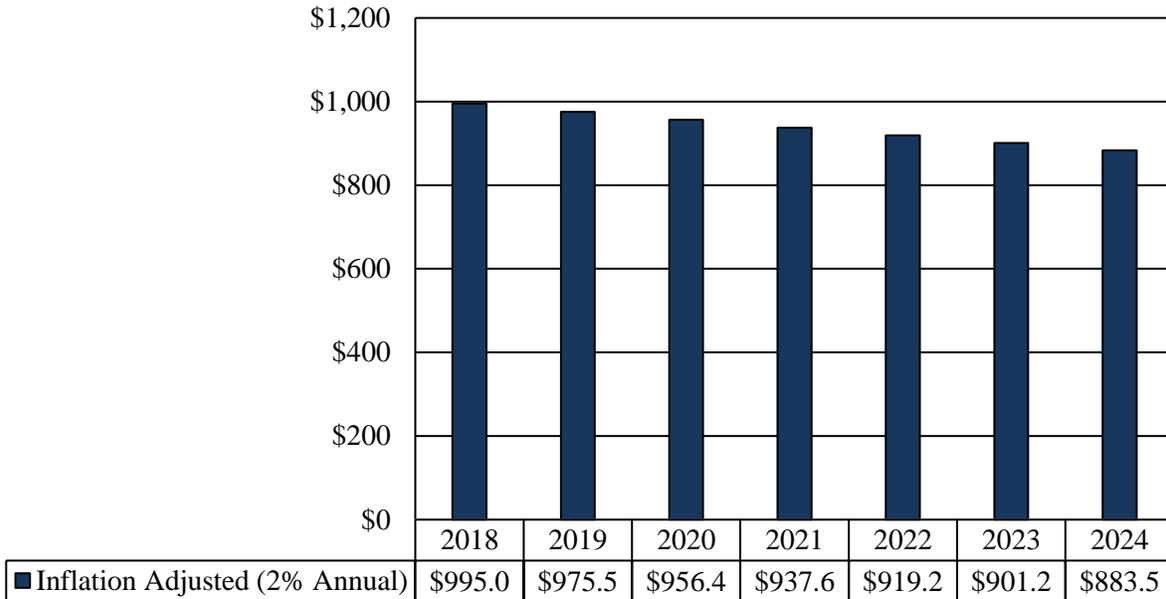
CDAC: Capital Debt Affordability Committee
 SAC: Spending Affordability Committee

Source: *Capital Debt Affordability Committee Recommendation of GO Bond Authorizations*, October 2016

CDAC Recommended GO Levels Do Not Provide for Annual Inflationary Increase

To account for the impact of inflation in the construction market, it has been CDAC policy to include annual increases of approximately 3.0% over the previous year's level. The 2016 CDAC recommendation, as was the case with the committee's 2015 recommendation, does not provide for annual inflationary adjustments, and instead keeps planned new GO bond authorization levels at \$995 million throughout the planning period. However, since 2006, the average annual increase in the producer price index for components of construction is 2.25%. Without the annual inflationary adjustment, the State's spending power will erode relative to the effects of inflation. **Exhibit 2** illustrates the impact that construction inflation estimated at 2.0% annually would have on future authorization levels.

Exhibit 2
Proposed New GO Bond Authorization Levels – Inflation Adjusted
Fiscal 2018-2024
(\$ in Millions)



GO: general obligation

Source: Department of Legislative Services

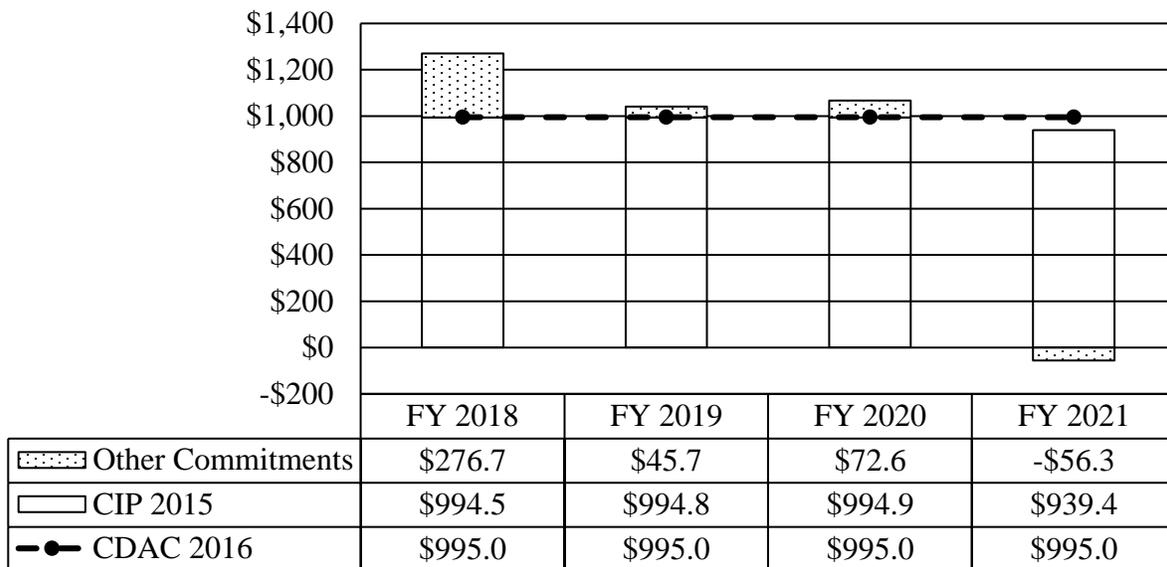
Capital Commitments Exceed Programmed Resources

In September 2016, the Board of Revenue Estimates revised general fund revenues downward, which included a \$251 million reduction in fiscal 2016 revenue attainment following the fiscal closeout and a write down in the amount of general funds estimated for fiscal 2017 by \$364 million and estimates for fiscal 2018 by \$417 million. To the extent that the State’s fiscal outlook does not improve, it will likely be difficult to supplement the capital program with general funds. However, mandates established through the 2016 session legislation, primarily in housing and community development programs as well as in mandates to repay portions of transfer tax revenues diverted to the General Fund, would require \$295 million in general funds above the \$4 million currently programmed in the 2016 session *Capital Improvement Program* (CIP) for fiscal 2018 through 2021.

The 2016 session, as well as budgetary actions taken by the Administration since the end of session, have also brought a multitude of pressure on the allocation of GO bond authorizations.

As illustrated in **Exhibit 3**, which shows the programmed levels of GO bond authorizations for the remaining four fiscal years in the 2016 CIP, GO bond capital commitments exceed the levels of GO bonds currently programmed and recommended in the forecast period.

Exhibit 3
Commitments Made in the 2016 Session Exceed Programmed GO Bond
Authorization Levels
Fiscal 2018-2021
(\$ in Millions)



CDAC: Capital Debt Affordability Committee

CIP: *Capital Improvement Program*

GO: general obligation

Source: Department of Legislative Services

These additional commitments include mandates established through legislation; capital programs and projects accelerated by the Administration and the General Assembly; preauthorization of projects not already included in the CIP; Administration proposed bond replacement for withdrawn fiscal 2017 general fund appropriations; and expressions of legislative intent through budget language. The impact these commitments will have on the fiscal 2018 capital budget will depend on how the Administration intends to treat each individual item, but the estimated impact is approximately \$276.7 million above what the CIP could accommodate in fiscal 2018 under the \$995 million limit recommended by CDAC.

Revenues and Taxes

Implementation of Casino Gaming

Casinos in Allegany, Anne Arundel, Baltimore City, Cecil, and Worcester counties are currently operating, with a Prince George’s County facility scheduled to open in December 2016. While gaming revenues in West Virginia declined in fiscal 2016, gaming revenues in Delaware and Pennsylvania fared better and increased in fiscal 2016.

Implementation of Video Lottery Terminals and Table Games

There are currently five casinos operating in Baltimore City and Allegany, Anne Arundel, Cecil, and Worcester counties, as originally authorized by the voters by constitutional amendment in 2008. **Exhibit 1** shows the number of video lottery terminals (VLT) and table games in operation at each facility as of September 30, 2016.

Exhibit 1
Number of VLTs and Table Games in Operation by Facility

<u>Facility</u>	<u>VLTs</u>	<u>Table Games</u>
Anne Arundel	3,907	206
Baltimore City	2,202	179
Cecil	850	22
Worcester	800	0
Allegany	634	17
Total	8,393	424

VLT: video lottery terminal

Source: State Lottery and Gaming Control Commission

A sixth facility in Prince George’s County was authorized by voter referendum in 2012 and is scheduled to open on December 8, 2016, with 3,321 VLTs and 165 table games.

VLT and Table Game Revenues

Exhibit 2 shows actual and anticipated gross VLT and table game revenues for fiscal 2011 through 2019 (not including one-time initial license fees) by facility. **Exhibit 3** shows the same revenues (not including one-time initial license fees) by fund.

Exhibit 2
Gross Gaming Revenues Generated by Facility
Fiscal 2011-2019
(\$ in Millions)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Est.</u> <u>2017</u>	<u>Est.</u> <u>2018</u>	<u>Est.</u> <u>2019</u>
<u>VLTs</u>									
Anne Arundel		\$28.5	\$431.1	\$419.0	\$391.8	\$408.8	\$388.0	\$357.4	\$360.2
Baltimore City					131.9	168.3	165.3	163.3	164.6
Cecil	\$82.7	118.1	76.0	72.1	66.1	65.7	65.3	64.9	65.5
Worcester	20.4	48.0	50.4	52.0	53.1	57.6	59.2	61.0	61.9
Allegany			2.8	35.3	38.0	41.3	43.3	44.9	45.5
Prince George's							195.3	452.8	462.0
Total VLTs	\$103.1	\$194.5	\$560.3	\$578.4	\$681.0	\$741.7	\$916.4	\$1,144.2	\$1,159.8
<u>Table Games</u>									
Anne Arundel			\$41.6	\$235.4	\$233.8	\$242.0	\$232.6	\$219.0	\$220.5
Baltimore City					104.1	142.1	140.3	138.2	139.5
Cecil			6	13.6	11.9	11.6	11.0	10.6	10.8
Worcester									
Allegany			0.5	5.9	6.6	6.6	6.5	6.5	6.6
Prince George's							117.9	252.2	257.3
Total Table Games			\$48.0	\$254.9	\$356.4	\$402.3	\$508.2	\$626.6	\$634.5
Total VLT and Table Games	\$103.1	\$194.5	\$608.3	\$833.3	\$1,037.4	\$1,144.0	\$1,424.6	\$1,770.8	\$1,794.3

VLT: video lottery terminal

Note: Figures may not sum due to rounding.

Source: Department of Legislative Services

Exhibit 3
Gross Gaming Revenues Generated by Fund
Fiscal 2011-2019
(\$ in Millions)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Est.</u> <u>2017</u>	<u>Est.</u> <u>2018</u>	<u>Est.</u> <u>2019</u>
<u>VLTs</u>									
Education Trust Fund	\$50.1	\$94.3	\$274.7	\$277.1	\$316.1	\$322.0	\$376.3	\$452.3	\$458.6
Lottery Operations	2.1	3.9	11.2	11.6	11.9	7.8	9.6	11.9	12.1
Purse Dedication Account	7.2	13.6	39.1	38.9	46.0	50.1	57.0	67.1	68.0
Racetrack Renewal Account	2.6	4.9	10.8	9.5	7.1	7.0	8.7	11.0	11.1
Local Impact Grants	5.7	10.7	30.7	30.8	36.4	39.7	49.2	61.7	62.5
Business Investment	1.5	2.9	8.4	8.4	9.9	10.8	13.4	16.8	17.1
Licensees	34.0	64.2	185.4	202.1	253.6	304.3	402.2	523.4	530.4
Total VLTs	\$103.1	\$194.5	\$560.3	\$578.4	\$681.0	\$741.7	\$916.4	\$1,144.2	\$1,159.8
<u>Table Games</u>									
Education Trust Fund			\$9.6	\$51.0	\$71.3	\$80.5	\$86.4	\$94.0	\$95.2
Local Impact Grants							15.2	31.3	31.7
Licensees			38.4	203.9	285.1	321.8	406.5	501.3	507.6
Total Table Games			\$48.0	\$254.9	\$356.4	\$402.3	\$508.2	\$626.6	\$634.5
Total VLT and Table Games	\$103.1	\$194.5	\$608.3	\$833.3	\$1,037.4	\$1,144.0	\$1,424.6	\$1,770.8	\$1,794.3
Education Trust Fund	\$50.1	\$94.3	\$284.3	\$328.1	\$387.4	\$402.5	\$462.7	\$546.3	\$553.8

VLT: video lottery terminal

Note: Figures may not sum due to rounding.

Source: Department of Legislative Services

Gaming in Surrounding States

Since fiscal 2012, gaming revenues at Charles Town, Delaware Park, and Dover Downs have each decreased by approximately 30%, while gaming revenues from Philadelphia casinos have only decreased by 1%.

Delaware's fiscal 2016 VLT revenues increased by 0.7% from the prior year, while table game revenues increased by 4.4%. West Virginia's fiscal 2016 VLT revenues decreased by 3.6%, and table game revenues declined by 7.2%. Pennsylvania's overall gaming revenues have

fared better than in Delaware and West Virginia, as Pennsylvania's VLT revenues increased by 2.3%, and table game revenues increased by 7.6% in fiscal 2016. Only one of the three Philadelphia area casinos experienced a decrease in VLT and table game revenues in fiscal 2016.

Revenues and Taxes

Daily Fantasy Sports

Daily fantasy sports competitions have drawn increased scrutiny from regulators as to whether these competitions should be considered a form of gambling. While legislation to authorize daily fantasy sports competitions has been enacted in nine states since 2015, legislation to expressly authorize and regulate daily fantasy sports competitions in Maryland did not pass during the 2016 legislative session. While the Comptroller has now proposed regulations to govern these competitions, the regulations are on hold, pending further study.

Overview

Daily fantasy sports are a form of gaming in which participants' fantasy teams compete against each other based on professional player or team statistics. Daily fantasy sports operate on a shorter time table than traditional fantasy sports competitions. Participants in daily fantasy sports competitions draft a team for a period of time that is less than a full season. The outcome of the competition is determined by statistics generated by the team of players drafted. The Fantasy Sports Trade Association estimates that 57.4 million individuals played fantasy sports in 2016.

Legality of Daily Fantasy Sports

Federal Law

Fantasy sports competitions have not been challenged under the Professional and Amateur Sports Protection Act or the Wire Act because generally the activity has not been viewed as a game of chance or gambling. In addition, the Unlawful Internet Gambling Enforcement Act includes an exemption for fantasy sports if (1) the value of prizes is not dependent on the number of players; (2) the outcome is determined by fantasy player skill and knowledge; and (3) the outcome cannot be determined by the score of the game or based solely on one individual player's performance. This exemption, however, does not preempt state laws governing daily fantasy sports, and these competitions must still comply with each state's specific laws governing gambling and lotteries.

State Laws

While daily fantasy sports competitions are widely advertised across the country, these competitions have ceased in some states where regulators, court decisions, or Attorneys General have raised questions about their legality. Almost all daily fantasy sports operators currently refuse to take customers from 10 states, and there are an additional 5 states where only some of the daily fantasy sports operators will accept customers.

States Authorizing Daily Fantasy Sports

In 2015, Kansas became the first state to enact legislation expressly authorizing daily fantasy sports. The Kansas legislation authorized daily fantasy sports but did not provide for regulation of the industry. In 2016, 33 states considered and 8 states enacted legislation to authorize and regulate daily fantasy sports. The states that enacted legislation in 2016 are Colorado, Indiana, Massachusetts, Mississippi, Missouri, New York, Tennessee, and Virginia.

Regulatory Body

While the daily fantasy sports industry considers its competitions to be games of skill and has fought to avoid being labeled as gambling, four of the states enacting legislation in 2016 required the body that oversees gaming or lotteries in the state to regulate daily fantasy sports. The other four states enacting legislation assigned nongaming regulatory bodies to regulate the industry.

Consumer Protections

Each state that passed daily fantasy sports legislation in 2016 included consumer protection provisions. In general, these provisions are designed to prevent employees and their immediate relatives from playing in contests, ensure the security of data at the sites, segregate player funds from operational funds, distinguish highly experienced participants, and require participants to be at least 18 or 21 years old.

Taxes and Fees

The tax and fee structure varies widely among the states that enacted daily fantasy sports legislation. Daily fantasy sports operators offering competitions in Indiana, Missouri, New York, and Tennessee must pay an annual tax or fee, while operators in Virginia must pay a one-time registration fee. Colorado requires the oversight body with jurisdiction over daily fantasy sports to establish license fees. Massachusetts and Mississippi do not currently impose any taxes or fees on daily fantasy sports operators.

Daily Fantasy Sports in Maryland

In 2012, Maryland became one of the first states to enact legislation directly addressing fantasy sports. Chapter 346 of 2012 exempts a specified “fantasy competition” from prohibitions against betting, wagering, and gambling in State law. Chapter 346 defines fantasy competition as any online fantasy or simulated game or contest such as fantasy sports in which (1) participants own, manage, or coach imaginary teams; (2) all prizes and awards offered to winning participants are established and made known to participants in advance of the game or contest; and (3) the winning outcome of the game or contest reflects the relative skill of the participants and is

determined by statistics generated by actual individuals. Chapter 346 authorizes the Comptroller's Office to adopt regulations to carry out the provisions of the Act.

In January 2016, the Office of the Attorney General issued a letter of advice on whether Chapter 346 had the effect of expanding commercial gaming in the State and, therefore, should have been subject to a voter referendum as required by Article XIX of the Maryland Constitution. The Attorney General's Office concluded that Chapter 346 clearly authorized traditional fantasy sports competitions that do not constitute commercial gaming and are, therefore, not subject to a voter referendum. However, to the extent that Chapter 346 authorized daily fantasy sports competitions, the Attorney General's Office concluded that the Act should have been referred to voter referendum. Due to the substantial uncertainty surrounding the issue, the Attorney General recommended that the General Assembly clarify whether daily fantasy sports are authorized in Maryland.

During the 2016 legislative session, the General Assembly considered but did not pass daily fantasy sports legislation. Senate Bill 980 would have prohibited a fantasy competition that includes any online fantasy or simulated game or contest, such as fantasy sports, if the provider or vendor of the game or contest requires the payment of an entry fee in order to participate in the game or contest and receive a prize. Senate Bill 976 and House Bill 930 both attempted to authorize and regulate daily fantasy sports competitions. Senate Bill 976 was contingent on daily fantasy sports competitions being authorized by voter referendum as required by Article XIX.

In the August 19, 2016 issue of the *Maryland Register*, the Comptroller published proposed fantasy sports regulations. The stated purpose of the regulations is to ensure that fantasy sports competitions are conducted on a fair and level playing field, and to provide disclosure of information regarding players' tax obligations. The proposed regulations also contain many of the consumer protection provisions incorporated in legislation enacted in other states.

On October 3, 2016, the Joint Committee on Administrative, Executive, and Legislative Review notified the Comptroller of the committee's intent to conduct a more detailed study of the proposed regulations. The letter asks that the Comptroller delay final adoption of the regulations while the committee examines a number of issues relating to whether the statutes under which the regulations were proposed authorize their adoption and whether the regulations conform to the legislative intent of the statutes.

Revenues and Taxes

Evaluation of the Job Creation and Businesses That Create New Jobs Tax Credits

The Tax Credit Evaluation Act requires an evaluation of the job creation and businesses that create new jobs tax credits by July 1, 2017, and the Department of Legislative Services (DLS) evaluated each credit during the 2016 interim. Considering the job creation tax credit's modest incentive and overlap with other employment tax credits, DLS recommends that the General Assembly consider eliminating the tax credit or consolidating the credit along with other employment tax credits. While DLS recommends that the General Assembly consider eliminating the businesses that create new jobs tax credit, a failure by various State agencies and local governments to provide adequate information prevented DLS from satisfactorily evaluating the credit.

Tax Credit Evaluation Act

In response to concerns about the fiscal impact of tax credits on State finances, Chapters 568 and 569 of 2012, the Tax Credit Evaluation Act, established a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee that is appointed jointly by the President of the Senate and the Speaker of the House of Delegates. The Act requires that the evaluation committee review specified tax credits each year.

To assist the committee in its work, the Department of Legislative Services (DLS) is required to publish a report evaluating the tax credit, which must discuss (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments. During the 2016 interim, DLS evaluated the job creation and businesses that create new jobs tax credits, as the evaluation committee is required to review these credits by July 1, 2017.

Job Creation Tax Credit

First enacted in 1996, the job creation tax credit provides a tax credit to businesses that expand or establish a facility in Maryland that results in the creation of new jobs. During fiscal 2002 through 2016, the Department of Commerce issued 208 certifications to 101 businesses that reported creating 17,692 jobs. Tax credits during that time period totaled an estimated \$21.8 million (in current 2016 dollars). Minimum job creation and other program eligibility requirements limit the ability of new or smaller businesses to receive the credit, so participating businesses are much more likely to be large established companies.

In Maryland, there is significant overlap between the job creation tax credit and other State employment tax credits, like the enterprise zone, One Maryland, and businesses that create new jobs programs. While there are many similarities between these employment tax credit programs, the job creation tax credit is not as generous as other employment tax credits. DLS estimates that the job creation tax credit comprises less than 0.4% of an employer's total costs after considering additional compensation costs and additional years of unsubsidized employment, so the credit is unlikely to increase employment unless a business believes there is sufficient demand for their product.

Considering the job creation tax credit's modest incentive and overlap with other employment tax credits, DLS recommends that the General Assembly consider eliminating the tax credit or consolidating the credit along with other employment tax credits. If the General Assembly decides not to eliminate the credit or to consolidate employment tax credits, the report includes several recommendations that could improve the credit.

Businesses That Create New Jobs Tax Credit

Businesses located in Maryland that create new positions and establish or expand business facilities in the State may be entitled to the businesses that create new jobs tax credit. To be eligible for the State tax credit, businesses must first have been granted a property tax credit by a local government for creating the new jobs. The business must create at least 25 new positions as part of the new or expanded business facility unless it is located in a rural county, in which case only 10 new positions must be created. Enhanced credits are available if certain conditions are met and the program provides for specific requirements for businesses located in Montgomery County.

DLS reviewed the businesses that create new jobs credit but was unable to satisfactorily evaluate the credit, primarily due to failures by various State agencies and local governments to certify and collect information about the credit. As such, DLS was only able to obtain limited information about program costs in Montgomery County. Of the 16 businesses that have claimed the credit in Montgomery County, 15 have claimed a total of \$12.3 million in standard credits while 1 company – Discovery Communications – has claimed a total of \$43.1 million in enhanced credits.

The lack of credit transparency mentioned above prevented DLS from (1) verifying that credits are being awarded and claimed as required by statute; (2) determining the full economic impacts of the program; (3) calculating the program's fiscal costs; and (4) analyzing whether the program is effective in achieving its objectives. Considering the businesses that creates new jobs tax credit's complexity and lack of transparency, DLS recommends that the General Assembly consider eliminating the tax credit. If the General Assembly decides not to eliminate the credit, DLS makes a number of recommendations that would improve credit transparency and data collection.

Personnel

State Workforce and Payroll

Since fiscal 2004, the total number of budgeted State positions has increased from 77,861 to 80,323. Declines in State agency positions were offset by increases in higher education and judicial positions. From fiscal 2016 to 2017, personnel costs increase by 2.3%. Salary costs decrease by 0.6%, while other benefit costs increase by 15.7%. From fiscal 2004 to 2015, the average employee's salary increased at a rate of 2.4% annually. Higher growth in benefit costs results in benefits' share increasing from 23.0% to 30.0% of total costs.

Fiscal 2017 Budgeted Regular Positions and Compensation

Regular full-time equivalent positions are requested by the Administration and authorized by the General Assembly when the State budget is passed. Section 33 of the fiscal 2017 budget bill limits position growth above that level by allowing the Board of Public Works to authorize no more than 100 additional positions during fiscal 2017, outside of exempted provisions for hardship, manpower, statutes, block grants, new facilities, and/or emergencies (not including higher education institutions). To date, the board has not created any new positions using this authority.

Budget spending limits, position caps restricting growth, attrition, and abolitions prompted by budgetary constraints have decreased the nonhigher education Executive Branch workforce from 52,941 positions in fiscal 2004 to 49,992 in the fiscal 2017 legislative appropriation, a reduction of 2,949 positions. These declines were offset by adding 4,664 positions in higher education institutions. **Exhibit 1** shows that the total number of positions decrease by 551 from fiscal 2016 to 2017, primarily as a result of Section 20 of the fiscal 2017 budget bill as introduced, which required the Governor to abolish 657 regular positions in the Executive Branch; the General Assembly amended the language to restrict abolished positions to only "vacant" positions. Reductions in Executive Branch positions were partially offset by adding 37 positions in the Judiciary.

The budgeted expenditure for salaries totals \$5.4 billion in fiscal 2017, while other compensation adds another \$2.7 billion in costs. **Exhibit 2** shows that salaries decrease slightly in fiscal 2017, despite State employees receiving increments.¹ The slight decline in salaries is not surprising given that the workforce has shrunk.

¹ State Law Enforcement Officers Labor Alliance members receive both increments and a 2% general salary increase in fiscal 2017 as part of a collective bargaining agreement. Officers who missed step increases from fiscal 2010 to 2013 also receive compensation in fiscal 2017.

Exhibit 1
Regular Full-time Equivalent Positions Changes
Fiscal 2004 Actual to Fiscal 2017 Legislative Appropriation

<u>Department/Service Area</u>	<u>2004 Actual</u>	<u>2016 Working Approp.</u>	<u>2017 Legis. Approp.</u>	<u>2016-2017 Change</u>
Health and Human Services				
Health and Mental Hygiene	7,710	6,353	6,183	-170
Human Resources	7,140	6,360	6,265	-95
Juvenile Services	1,939	2,055	1,999	-56
Subtotal	16,789	14,768	14,447	-321
Public Safety				
Public Safety and Correctional Services	11,231	11,025	10,956	-69
Police and Fire Marshal	2,480	2,438	2,436	-2
Subtotal	13,711	13,463	13,392	-71
Transportation	9,096	9,126	9,108	-18
Other Executive				
Legal (Excluding Judiciary)	1,445	1,501	1,473	-28
Executive and Administrative Control	1,572	1,626	1,577	-50
Financial and Revenue Administration	2,032	2,119	2,107	-12
Budget and Management and DoIT	472	460	484	24
Retirement	181	213	210	-3
General Services	728	578	582	5
Natural Resources	1,454	1,321	1,326	5
Agriculture	436	380	366	-14
Labor, Licensing, and Regulation	1,519	1,603	1,528	-76
MSDE and Other Education	1,892	1,940	1,957	18
Housing and Community Development	366	337	330	-7
Commerce	299	208	194	-14
Environment	951	939	913	-26
Subtotal	13,346	13,223	13,046	-177
Executive Branch Subtotal	52,941	50,579	49,992	-587
Higher Education	20,967	25,632	25,631	-1
Executive and Higher Education Subtotal	73,908	76,211	75,623	-588
Judiciary	3,224	3,914	3,951	37
Legislature	730	749	749	0
Grand Total	77,861	80,874	80,323	-551

DoIT: Department of Information Technology

MSDE: Maryland State Department of Education

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

Exhibit 2
Regular Employee Compensation
Fiscal 2016 Working Appropriation to 2017 Legislative Appropriation
(\$ in Millions)

	<u>2016 Working Appropriation</u>	<u>2017 Legislative Appropriation</u>	<u>2016 to 2017 \$ Change</u>	<u>2016 to 2017 % Change</u>
Earnings				
Salary	\$5,304.9	\$5,275.5	-\$29.4	-0.55%
Other Earnings ¹	136.4	157.7	21.4	15.66%
Earnings Subtotal	\$5,441.3	\$5,433.3	-\$8.0	-0.15%
Other Compensation				
Health ²	\$1,168.1	\$1,263.2	\$95.2	8.15%
Retirement/Pensions ³	826.9	924.7	97.8	11.83%
Salary-dependent Fringe ⁴	400.4	398.4	-2.0	-0.49%
Agency-related Fringe ⁵	109.7	\$106.0	-3.7	-3.41%
Other Compensation Subtotal	\$2,505.0	\$2,692.3	\$187.3	7.48%
Total Compensation	\$7,946.3	\$8,125.5	\$179.2	2.26%

¹Overtime and Shift Differentials.

²Employee and Retiree Health Insurance.

³All Pension/Retirement Systems.

⁴Social Security and Unemployment Compensation.

⁵Other Post-Employment Benefits, Deferred Compensation Match, Workers' Compensation, and Tuition Waivers.

Note: Includes higher education and Judicial and Legislative branches.

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

Spending growth is attributable to increases in other compensation costs. Most significantly, retirement costs increase 11.8%, primarily due to rate changes. Another notable increase is health insurance, primarily driven by rising prescription drug costs. While medical plans have grown at an annual rate of 4.8% from fiscal 2013 to 2016, prescription drugs have grown at an annual rate of 14.5% during that same time period. In fiscal 2016, prescription drug expenditures amounted to \$520 million, approximately one-third of total claims. As the growth in prescription drug costs shows no sign of slowing, required contributions will need to increase to keep pace with health expenditures over time, or plan changes will be needed to mitigate rising costs.

Salary and Benefits History

In its annual personnel report, the Department of Budget and Management provides personnel cost data. **Exhibit 3** shows that fringe benefit costs are increasing at a faster rate than salaries, accounting for 30.0% of the total cost share of an average employee in fiscal 2015 in comparison to 23.0% in fiscal 2004. From fiscal 2004 to 2015, fringe benefits increased by an annual rate of 6.2%, while salaries increased by 2.4% during the same timeframe. Pension contributions are the primary driver of the increase with an annual growth of 14.5%. Health insurance costs, with an annual growth of 3.6%, are somewhat understated in fiscal 2015 as contributions were lowered in fiscal 2014 and 2015 to work down a fund balance, as a result of plan changes. Health insurance costs will increase in fiscal 2016 as the fund balance is used up.

Exhibit 3 Change in Direct Salary and Benefit Costs for the Average Employee Fiscal 2004 and 2015

	<u>2004</u>	<u>2015</u>	<u>Total Change</u>	<u>Annual % Change</u>
Salary	\$42,505	\$55,275	\$12,770	2.4%
Health Insurance Payments	6,483	9,548	3,065	3.6%
Pension Contributions	2,067	9,142	7,075	14.5%
Other Fringe Benefits	3,832	5,244	1,412	2.9%
Total	\$54,887	\$79,209	\$24,322	3.4%
 Fringe Benefit Share of Total Cost	 23.0%	 30.0%		

Note: Does not include nonbudgeted agencies, higher education, Legislative or Judicial branches. Starting after fiscal 2015, noncontractual temporary employees are excluded. Salary data prior to this change may have been systematically underestimated.

Source: Department of Budget and Management Annual Personnel Reports (Fiscal 2004 and 2015)

The increasing State share of the cost of benefits was mitigated by increasing employees' share of the costs. Retirement contributions in the employees' and teachers' plans increased from 2% of salary in fiscal 2004 to 7% of salary.² State health insurance costs were mitigated by actions such as increasing the employee share of premium costs, increasing coinsurance costs, and increasing prescription drug copayments.

² Employee contributions increased to 3% of salary in fiscal 2007, 4% in fiscal 2008, 5% in fiscal 2009, and 7% in fiscal 2012.

The average employee salary increased from approximately \$42,505 in fiscal 2004 to \$55,275 in fiscal 2015; however, growth has not been continuous. During that time period, there have been four years without general salary increases or increments, and two years (fiscal 2010 and 2011) where salaries decreased as a result of furloughs. The strongest sustained salary growth of the period was from fiscal 2005 to 2009, when salaries grew at an annual rate of 3.2%. The period with the weakest growth was from fiscal 2009 to 2013, when salaries grew at an annual rate of 0.2%. No general salary increases or increments were provided in fiscal 2016. Increments were budgeted in the fiscal 2017 legislative appropriation, but no general salary increase.

Personnel

State Employee and Retiree Health Plan

In response to rising health care costs, the State has modified its health plans by increasing employee costs, such as adding coinsurance to preferred provider organizations. These changes have resulted in a migration of employees into exclusive provider organizations, which provide in-network benefits only and do not have as much employee cost sharing. The wellness program has been modified so that there is no longer a surcharge for nonparticipation. Prescription drug costs continue to increase at a higher rate than other health care costs.

Plan Changes and Membership Migration

The State has traditionally offered a generous array of health benefits, including medical, behavioral, prescription drug, dental, vision, life insurance, accidental death and dismemberment, and long-term care insurance. Due to concern about rising costs and the prevalence of chronic illness among State employees and dependents, the State implemented changes to employee and retiree health care plans in 2012. Employees have a choice among three types of health plans: Preferred Provider Organization (PPO), which utilizes a national network and provides both in- and out-of-network benefits; Exclusive Provider Organization (EPO), which utilizes a national network and provides in-network benefits only; and Integrated Health Model (IHM), which utilizes a regional network.

Migration into EPO plans started July 2012 when the State introduced increased coinsurance payments for PPO and point of service (POS) plans. POS plans were discontinued in fiscal 2015, except for State Law Enforcement Officers Labor Alliance members, and were replaced by the IHM plan, resulting in gains for both EPO and PPO plans, but more members migrated to EPO plans. Since then, EPO membership has grown steadily and exceeded PPO plan membership for the first time in fiscal 2015 with 50.4% of medical plan membership; this trend in EPO membership is expected to continue.

Wellness Program Update

In addition to plan changes, the State developed a wellness program intended to phase in delivery system reforms, cost-sharing incentives for employees to engage in wellness activities, and health education over the course of six years. Completing wellness requirements each year results in waived Primary Care Physician (PCP) copays. Failure to complete requirements would have resulted in an annual premium or surcharge; however, on January 19, 2016, Governor Lawrence J. Hogan, Jr. announced removal of the surcharge for nonparticipation indefinitely. Additionally, age/gender recommended biometric screenings and disease management are voluntary activities resulting in no surcharge for nonparticipation, copays will

continue to be waived in calendar 2016 for members who completed calendar 2015 activities, and members who did not complete calendar 2015 activities still have an opportunity to receive waived copays by completing the activities in calendar 2016. The calendar 2017 wellness activities are to select a PCP (if you have not already) and complete an online health risk assessment. Within 30 days of completing calendar 2017 activities, PCP copays will be waived. In addition, completing any voluntary age/gender recommended screenings will result in a \$5 reduction in specialist copays.

As of January 1, 2016, 50,067 employees, non-Medicare eligible retirees, and spouses who are enrolled in medical plans – representing 40% of eligible members – had met the healthy activity requirement for copay waiver³.

The 2016 *Joint Chairmen's Report* requests the Department of Budget and Management to submit a report to the budget committees by January 1, 2017, providing details on the revised wellness program, including what impact the recent program changes will have on employee and retiree health and costs and savings to the State.

Prescription Drugs Driving Health Insurance Costs

Despite an increase in the use of generic medications, prescription drugs have been driving health care costs. Pharmaceutical manufacturers have steadily increased the cost of medications in recent years, citing research and development funding needs. High price tags of specialty medications are major contributors to the State's rising costs for brand name drugs as more participants use these medications. For instance, treatment for Hepatitis C can cost \$100,000 per patient. Medications for treatment of chronic illnesses, such as diabetes and high cholesterol, also top the charts as cost drivers for the State. From fiscal 2013 to 2016, prescription costs for the State increased by \$173.6 million, or 14.5% annually. Prescription drug cost increases show no signs of slowing in the out-years and, as a result, either State agency, employee, and retiree contributions will need to increase, or plan changes will be needed to continue to cover costs.

³ Department of Budget and Management Office of Personnel Services and Benefits.

State Retirement and Pension System Investment Performance and Contribution Rates

The pension fund's fiscal 2016 return on investments was 1.16%, which is well below the assumed rate of return. The system's asset valuation policy smooths gains and losses over five years. The plan's funded status increased to 69.5%, compared to 68.6% at the end of fiscal 2015. Supplemental contributions of \$75 million will continue until the system is 85.0% funded, and a pension sweeper provision will direct a portion of unspent State general fund balances to the system.

Investments Fail to Meet Assumed Rate of Return

The State Retirement and Pension System's (SRPS) investment return for the fiscal year that ended on June 30, 2016, was 1.16%, failing to meet the assumed rate of return of 7.55%. The performance was driven primarily by the system's growth equity holdings, which made up 46.6% of the portfolio and returned -1.82% for the fiscal year. Within this asset class, public equity returned -4.31%, 46 basis points below benchmark. Private equity, comprising 9.2% of system assets had another strong year with a return of 9.94%, significantly outperforming its benchmark of 4.59%. The rate-sensitive asset class returned 9.34%, but was 131 basis points below its benchmark. Real assets and absolute return sustained losses and also underperformed their asset class benchmarks.

Failing to meet its assumed rate of investment return for the second year in a row, the system as a whole underperformed its policy benchmark by 54 basis points. Total system return for fiscal 2012 through 2016 is 5.68%, which is 72 basis points above the plan return benchmark for that period, though below the assumed rate of return.

The System's Financial Condition Driven by Investment Returns and Policy Changes

From fiscal 2015 to 2016, SRPS's funded status (the ratio of projected actuarial assets to projected actuarial liabilities) improved from 68.6% at the end of fiscal 2015 to 69.5% at the end of fiscal 2016 (these figures exclude funding for local governments that participate in the State plan). Total State liabilities increased from \$61.4 billion to \$62.8 billion, with the unfunded liability decreasing from \$19.3 billion to \$19.1 billion.

Assuming market conditions allow for investments to meet or exceed the 7.55% assumed rate of return moving forward, several combined factors mean that the system is poised to show continued improvement in its funding status, including the increasing number of new members entering the system under the reformed benefit structure enacted in 2011, the elimination of the

corridor funding method, and continued supplemental contributions above the actuarially determined contribution.

System Contribution Funding at Actuarial Determined Contribution Rates

Exhibit 1 shows that the employer contribution rate for teachers will decrease from 16.55% in fiscal 2017 to 16.45% in fiscal 2018, and the contribution rate for State employees will increase from 18.93% in fiscal 2017 to 19.22% in fiscal 2018. The aggregate State contribution rate, including contributions for public safety employees and judges, increases from 18.32% in fiscal 2017 to 18.34% in fiscal 2018. Based on projected payroll growth and other factors, the SRPS actuary estimates that total employer pension contributions will increase from \$1.891 billion in fiscal 2017 to \$1.907 billion in fiscal 2018.⁴ The funding rates and contribution amounts are inclusive of the required supplemental contributions required by Chapter 489 of 2015 (discussed below). The rates for the fiscal 2017 and 2018 contribution rates are the actuarially determined contribution rates.

Exhibit 1
State Pension Contributions
Fiscal 2017 and 2018
(\$ in Millions)

<u>Plan</u>	<u>2017</u>		<u>2018</u>	
	<u>Rate</u>	<u>Contribution</u>	<u>Rate</u>	<u>Contribution</u>
Teachers	16.55%	\$1,105.2	16.45%	\$1,122.6
Employees	18.93%	643.1	19.22%	639.1
State Police	82.50%	78.8	81.36%	79.8
Judges	46.56%	21.8	46.45%	21.8
Law Enforcement Officers	40.72%	42.1	40.77%	43.7
Aggregate	18.32%	\$1,890.9	18.34%	\$1,906.9

Note: Except for the Teachers' Combined System (TCS), contribution rates and dollar amounts reflect State funds only, excluding municipal contributions. For TCS, they reflect the combined total of State and local contributions. Figures also reflect the supplemental contributions established by Chapter 489 of 2015.

Source: Gabriel, Roeder, Smith & Co.

⁴ System contributions are based on the fiscal 2016 system valuation presented to the State Retirement and Pension System's Board of Trustees by the system actuary, Gabriel, Roeder, Smith, & Co.

Employer contribution rates were subject to multiple influences this year, some exerting upward pressure and others downward pressure. Investment returns over the five-year smoothing period exert upward pressure on the fiscal 2018 contribution rates. Increased membership under the reformed benefits exerts downward pressure on the rates. Chapter 489 eliminated the corridor funding method, which restricted the growth of contribution rates for the Teachers' Combined System (TCS) and the Employees' Combined System, the two largest plans within SRPS. By eliminating the corridor method, Chapter 489 ensured that the budgeted contribution rate is the actuarially determined rate necessary to fully fund the system. As the fiscal 2018 contribution rates are based off of the fiscal 2016 valuation, the corridor exerts minimal upward pressure on the fiscal 2018 rates.

In addition to eliminating the corridor method and returning the system to full actuarially determined funding, Chapter 489 also continues providing for a supplemental contribution of \$75.0 million each year until the system is 85% funded. Additionally, Chapter 489 included a sweeper provision, which will direct a portion of unspent general funds to the system as additional supplemental payments in fiscal 2017 through 2020. Since fiscal 2016 ended with an unappropriated fund balance, the Administration is required to include an additional \$50.0 million appropriation for State pension contributions. This is the maximum required by Chapter 489.

Under State law, employer contributions to the several systems provide for full funding of the actuarially determined contribution, pay the actuarially determined contribution in full, and additionally provide for regular supplemental payment above the actuarially determined contribution.

Local School Board Contributions to the Teachers' Pension System

Chapter 1 of the first special session of 2012 requires local school boards to make contributions for members of the Teachers' Retirement and Pension systems (TRS/TPS). The contribution amounts are the amounts associated with the normal cost for local employees in TRS/TPS. The normal cost is the portion of the yearly contribution rate, which reflects the amounts needed to fund liabilities that will be accrued in the upcoming year. For fiscal 2013 through 2016, the dollar amounts required to be paid by each local school board were set in statute. Starting in fiscal 2017, local school boards begin paying the full normal cost for their employees in TRS/TPS. The system's actuary projects the local school board normal cost share for fiscal 2018 to be \$280.5 million. The system's actuary projects the total State contribution to TCS will be \$842.1 million, which consists of \$24.5 million of the normal cost,⁵ \$766.8 million for unfunded liabilities, and \$50.8 million in supplemental contributions.

⁵ The State continues to be responsible for paying the normal cost for certain TRS/TPS covered employees, such as library employees and employees of an educational institution supported by and operated by the State.

Issues Associated with Defined Contribution Pension Plans

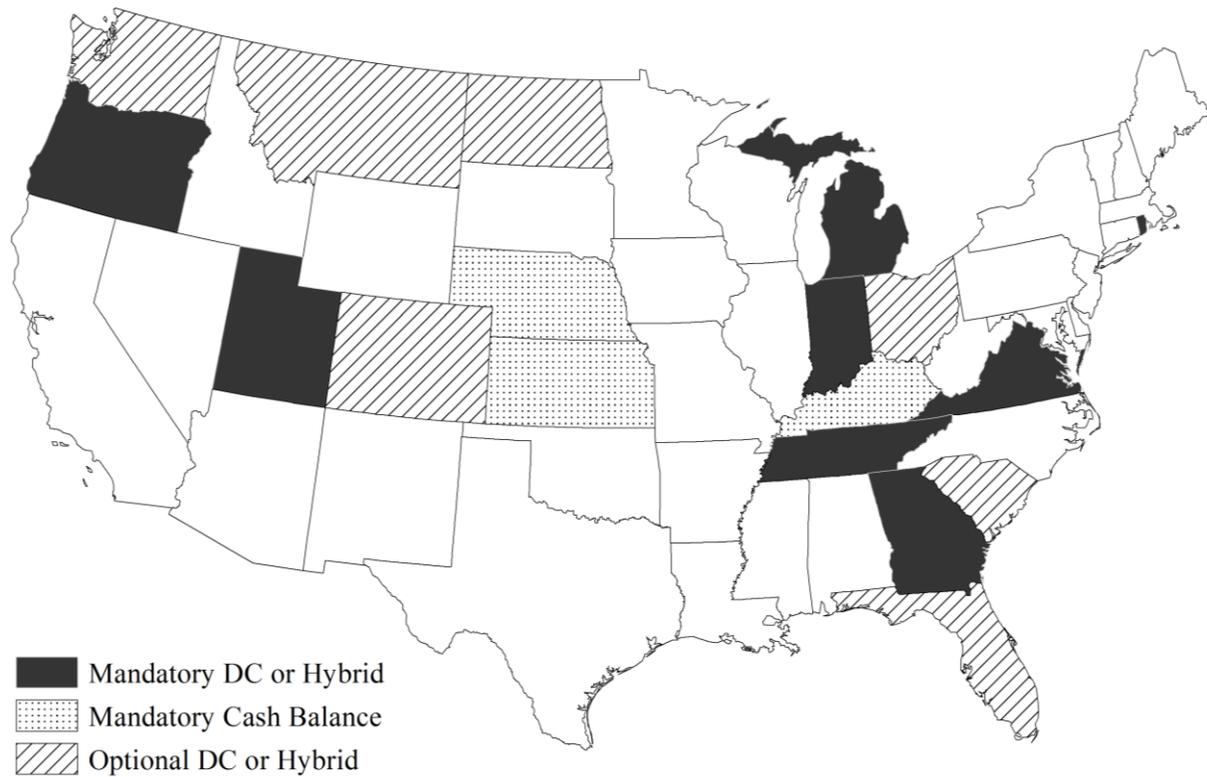
Most states offer their employees defined benefit (DB) retirement plans. About one-third of states have either closed those plans in favor of defined contribution (DC) or hybrid plans or offered their employees a choice between different plan types. Research has shown that DB plans are more cost effective than DC plans and that, when given a choice, employees tend to prefer the guaranteed benefits available from DB plans to alternative plan models. A concern about closing DB plans is that closing a DB plan does not eliminate accrued liabilities, but it does eliminate an important source of funding to cover those liabilities. Also, not all plan closings have been a success.

Defined Benefit Plans Remain the Norm, but Increasing Number of States Are Offering Alternative Retirement Plans

Most states offer their employees defined benefit (DB) retirement plans, but over the past two decades, about one-third of states have either closed those plans in favor of defined contribution (DC) or hybrid plans or offered their employees a choice between different plan types. A DB plan, like the Maryland State Retirement and Pension System, provides a retiree with a guaranteed benefit for life that is determined by a formula that takes into consideration the individual's years of service and compensation at the time of retirement. By contrast, under a DC plan, an employer provides a specific contribution that each employee invests in an individual account; the benefit is determined by the value of the investments in the individual account at the time of retirement.

A hybrid plan contains elements of both a DC and a DB plan. The most common hybrid approach involves offering a base DB plan with a lower benefit than is normally offered in DB-only plans and a supplemental DC plan that allows employees to accumulate wealth in an individual account. The Federal Employees Retirement System is an example of this approach. Another increasingly common approach is a cash balance plan, which provides notional individual accounts like DC plans but includes an employer-guaranteed level of annual asset growth in those accounts, even if the underlying investments lose value. For actuarial purposes, cash balance plans are considered DB plans and can be administered in conjunction with traditional DB plans with the plan sponsor pooling the cash balance assets with DB assets. **Exhibit 1** summarizes the states that require or offer DC, hybrid, or cash balance plans to state employees, teachers, or both. With the exception of Indiana's hybrid plan (1955), all of the DC, hybrid, and cash balance plans reflected in Exhibit 1 took effect after 1995.

Exhibit 1
States with Defined Contribution, Hybrid, or Cash Balance Retirement Plans



DC: defined contribution

Source: National Association of State Retirement Administrators; National Conference of State Legislatures; Pew Charitable Trusts

Research has shown that DB plans are more cost effective than DC plans and that when given a choice, employees tend to prefer the guaranteed benefits available from DB plans to alternative plan models. Multiple studies have found that for each dollar of benefit paid, DB plans are less expensive to administer and require lower contribution levels by employers and employees. The main reasons for this consistent finding are the pooling of both risk and assets that is available through a DB plan but not in DC plans. Another study examined the seven states shown in Exhibit 1 with optional DC or hybrid plans and found that fewer than one-third (3% to 26%) of eligible employees opted for a DC or hybrid plan in those states.

Closing a DB Plan Has Actuarial Implications That Can Increase Costs

All state DB plans elect to prefund their plans on an actuarial basis to minimize future costs and promote intergenerational equity. Actuarial funding calculates the total value of promised future benefits and then determines how much money must be contributed each year, taking into consideration anticipated investment income and other factors, to ensure that those benefits are fully funded. One of the goals of actuarial funding is budgetary stability by enabling plan sponsors to contribute either a level percentage of payroll or a level dollar amount each year to fund future benefits. The level percentage of payroll approach allows for low contribution amounts when a plan has a low covered payroll, with greater contributions required as the plan matures and payroll grows. A level dollar amount spreads contributions evenly across the years, requiring much larger contributions early in the plan's life compared with the level percentage of payroll approach.

The Governmental Accounting Standards Board (GASB) has allowed most actuarially funded DB plans to use either a level percentage of payroll or level dollar amortization policy when accounting for its assets and liabilities, but rules in effect prior to 2015 required that closed plans use only a level dollar amortization policy in their accounting. A closed plan is one that allows current members to remain and continue to accrue benefits but does not allow new members to join (and, therefore, contribute to the plan). The reason that GASB required level dollar amortization for closed plans is that covered payroll in those plans decreases, so a level percentage of payroll policy results in lower contributions over time even as benefits continue to be accrued, likely leaving the plan underfunded as its members approach retirement. A switch to level dollar amortization frontloads plan funding, which typically results in substantially higher employer contributions for several years.

Although GASB sets accounting standards for public pension plans, it does not dictate funding policies, and new GASB accounting rules in effect as of 2014 no longer require the use of level dollar amortization for closed plans even from an accounting standpoint. This gives closed plans some flexibility in setting their funding policies, and many states that have closed their DB plans in favor of DC plans have taken advantage of that flexibility, often with negative results. Although a number of factors besides the funding policy (*e.g.*, investment performance) can affect a plan's financial position, experience has shown that closing a DB plan in favor of a DC plan does not necessarily alleviate the financial strain on sponsors.

Michigan and West Virginia Experience Negative Effects of Closing DB Plans

Michigan and West Virginia were among the first states to close DB plans for either state employees or teachers and require them to join a DC plan. In both cases, the step was taken to alleviate either existing or anticipated budgetary strains stemming from the increasing costs associated with actuarial funding of their DB plans. In both cases, however, the switch to DC plans did not provide the anticipated relief.

In 1991, West Virginia closed its DB plan for teachers to new hires and required all new teachers hired in the state to join a DC plan. Due to years of underfunding, the closed plan had a funding ratio below 20.0%. Over the next 10 years, the funded ratio improved only slightly (from 11.6% in 1994 to 19.1% in 2003), the unfunded liability continued to grow despite no new members joining the plan, and the state's contributions to the plan also continued to grow (from \$220.5 million in 1998 to \$333.2 million in 2004). As a result, the state voted in 2005 to reopen the closed plan; 78.6% of teachers in the DC plan elected to transfer to the DB plan. The State also made a series of catch-up payments in 2006 and 2007, totaling more than \$1 billion, to raise the plan's funding level to 66.2% by fiscal 2014.

In 1996, Michigan closed its DB plan for state employees and required all new hires to enter a DC plan beginning in 1997. As shown in **Exhibit 2**, at the time the DB plan was closed, it was financially sound, with a 93.4% funding ratio. For five years following its closure, the DB plan's financial health actually improved and state contributions declined, in part because Michigan maintained a level percentage of pay funding model that kept required contributions at an artificially low level. Beginning in fiscal 2002, however, the state began severely underfunding its employer contribution, paying less than 50.0% of the actuarially required amount in both fiscal 2003 and 2004. With a declining funding ratio (79.8% in 2005), the state was confronting the possibility that the closed fund would not have sufficient resources to cover the cost of benefits for retirees. Therefore, it switched to a level dollar funding policy in fiscal 2005, which was partially responsible for a substantial increase in the actuarially required contribution. In most years since then, however, the state has failed to pay the higher required contributions, and by fiscal 2012, the funding ratio had dropped to 60.3%. An analysis by the Reason Foundation, which supports Michigan's decision to close its DB plan, found that if Michigan had kept its DB plan open, its funding ratio in fiscal 2015 would be slightly higher (67.7% if the plan had remained open vs. the actual rate of 66.1%), and the state would have saved \$1.1 billion in total state contributions for employee retirement in fiscal 2015.

Exhibit 2
Michigan State Employees' Retirement System Funding
(\$ in Millions)

<u>Fiscal Year</u>	<u>Unfunded Liability</u>	<u>Required Contribution</u>	<u>Actual Contribution</u>	<u>% Paid</u>	<u>Funded Ratio</u>
1995	\$771.0	\$261.0	\$307.0	118.0%	88.8%
1996	469.0	262.5	285.8	109.0%	93.4%
1997	-733.0	244.1	288.4	118.0%	109.0%
1998	-612.0	126.4	145.7	115.0%	107.2%
1999	-619.0	111.4	121.1	109.0%	106.9%
2000	-863.0	120.9	121.8	101.0%	109.1%
2001	-755.0	103.0	112.3	109.0%	107.6%
2002	137.0	111.6	87.5	78.0%	98.7%
2003	1,320.0	184.2	79.3	43.0%	88.8%
2004	1,855.0	262.5	103.9	40.0%	84.5%
2005*	2,503/0	308.2	256.4	83.0%	79.8%
2006	1,909.0	366.7	270.7	74.0%	85.1%
2007	1,818.0	316.1	150.9	48.0%	86.2%
2008	2,363.0	308.0	355.7	115.0%	82.8%
2009	3,127.0	351.6	343.8	98.0%	78.0%
2010	4,078.0	418.4	369.9	88.0%	72.6%
2011	5,385.0	447.9	424.5	95.0%	65.5%
2012	6,207.0	512.6	419.9	82.0%	60.3%

*Adoption of level dollar amortization.

Source: Michigan State Employees' Retirement System

Why Does Closing a DB Plan Often Cost More?

Structural issues associated with closing a DB plan can be exacerbated by poor implementation. Structurally, closing a DB plan does not eliminate accrued liabilities, but it does eliminate an important source of funding to cover those liabilities. Benefits that have been accrued by employees in a closed plan must still be paid upon their retirement, and that liability continues to grow as long as employees who remain in the plan continue working. To ensure that the fund has sufficient assets to pay those benefits, employers must continue to contribute the accrued liability payments for those employees that it would need to make whether the plan was open or closed. At the same time, closed plans lose both employer and employee contributions for new members, which would otherwise be used to help finance the plan. This effect can be ameliorated

by either (1) adopting a cash balance plan as an alternative to a DC plan, since contributions to cash balance plans can be pooled with DB plan assets; or (2) keeping the DB plan open and making the DC or hybrid plan optional. With respect to implementation, many states have interpreted the shift to a DC plan as an opportunity to underfund their closed DB plan, which occurred in both West Virginia and Michigan, as well as some other states that followed their example. If a state sets the employer contribution for the DC plan at a level higher than the normal cost for the DB plan, they can often find themselves paying more for retirement benefits than if they had left the DB plan open. Both Michigan and West Virginia found themselves in that position.

Education

State Education Aid and Maintenance of Effort

State education aid is projected to increase by a modest 1.8% in fiscal 2018, which includes a 2.6% increase in funds for local school boards offset by a reduction in State retirement costs. The Aging Schools Program will receive \$6.1 million in mandated funding in fiscal 2018, after receiving no funding in fiscal 2017 when funds were not released by the Governor. Several new programs established by 2016 legislation will also receive funding in fiscal 2018. Legislation may be considered in the upcoming session to extend the sunset date for the Hunger-Free Schools Act to hold participating school systems harmless from a loss of State compensatory education funding after fiscal 2018.

State Public Schools Aid Projected to Increase by \$116 Million

Public schools are expected to receive an estimated \$6.4 billion in fiscal 2018, representing a \$116.0 million (1.8%) increase over the prior fiscal year. The increase is comprised of aid that flows directly to local school boards, which is projected to grow by \$146.9 million (2.6%) offset by a \$30.9 million (4.0%) decrease in retirement aid. The increase in direct aid is driven by a slight expected rise in the per pupil foundation amount, projected enrollment increases, continued phase-in of Net Taxable Income (NTI) education grants, and new programs.

Foundation and Most Other Direct Aid Programs Will Increase Slightly

The foundation program is the major State aid program for public schools, accounting for nearly half of State education aid. For each school system, a formula determines the State and local shares of a minimum per pupil funding level, or “foundation.” The foundation program is projected to total \$3.0 billion in fiscal 2018, an increase of \$44.3 million (1.5%) over fiscal 2017, as shown in **Exhibit 1**. The increase is attributable to statewide enrollment growth of an estimated 0.86% (7,311 full-time equivalent students) and a 0.7% inflationary increase in the per pupil foundation amount, from \$6,964 to \$7,011. The 0.7% increase in the per pupil foundation amount in fiscal 2018 is equivalent to the estimated change in the Implicit Price Deflator for State and Local Government Purchases.

Although projected enrollment grows statewide, it varies by local school system, from an increase of 1.9% to a decline of 1.2%. Actual enrollment figures will not be available until January 2017. The fiscal 2017 budget included \$19.4 million in additional funds for local school systems that have experienced declining enrollment in recent years. This entails \$12.7 million for Baltimore City, \$1.1 million for Calvert County, \$4.0 million for Carroll County, \$1.3 million for Garrett County, and \$365,000 for Kent County. Kent County’s figure includes \$65,000 in

mandated funding for counties with small and declining enrollment populations. Current law does not require any similar funding in fiscal 2018.

Exhibit 1
Estimated State Aid for Education
Fiscal 2017 and 2018
(\$ in Thousands)

<u>Program</u>	<u>2017</u>	<u>Estimated 2018</u>	<u>\$ Change</u>	<u>% Change</u>
Foundation Program	\$2,961,988	\$3,006,291	\$44,302	1.5%
Geographic Cost Adjustment	136,898	139,050	2,152	1.6%
Foundation – Special Grants	19,430	0	-19,430	-100.0%
Supplemental Grant	46,620	46,620	0	0.0%
Net Taxable Income Grants	39,702	50,890	11,188	28.2%
Compensatory Education Program	1,309,146	1,362,211	53,065	4.1%
Special Education Formula	279,608	283,773	4,166	1.5%
Nonpublic Placements	126,618	126,096	-522	-0.4%
Limited English Proficiency	227,020	246,129	19,110	8.4%
Guaranteed Tax Base	54,511	52,065	-2,447	-4.5%
Student Transportation	270,801	275,722	4,921	1.8%
Aging Schools	0	6,109	6,109	
Other	70,610	94,876	24,267	34.4%
<i>Direct Aid Subtotal</i>	<i>\$5,542,952</i>	<i>\$5,689,833</i>	<i>\$146,881</i>	<i>2.6%</i>
Teachers' Retirement	767,255	736,364	-30,891	-4.0%
Total	\$6,310,207	\$6,426,197	\$115,991	1.8%

Source: Department of Legislative Services

Other than the foundation program, the compensatory education and limited English proficiency formulas are projected to have the largest dollar increases among the direct aid programs in fiscal 2018. A portion of the increase in each program is due to projected enrollment growth in students eligible for free and reduced-price meals and English language learners, respectively, and the rest of the increases can be attributed to the slight increase in the per pupil foundation amount.

Approximately 75% of State aid to public schools is distributed inversely to local wealth, whereby the less affluent school systems receive relatively more State aid. NTI is one component of calculating local wealth for purposes of State aid for education. Chapter 4 of 2013 provides additional education grants in counties whose formula aid is higher using November NTI as compared to September NTI. Chapter 489 of 2015 delayed the scheduled phase-in of the grants

by one year, with funding fully phased in by fiscal 2019. NTI education grants increase to an estimated \$50.9 million in fiscal 2018 to be distributed to an estimated 18 school systems.

Aging Schools and New Programs in Fiscal 2018

Fiscal 2018 reflects a \$6.1 million increase in funding for the Aging Schools Program, after the program received no funding for fiscal 2017. During the 2016 session, the General Assembly allocated funding for the program as pay-as-you-go through the State Reserve Fund in the fiscal 2017 budget, provided that the Governor chose to release it. However, the Governor has announced that he will not be releasing any funds fenced off through the State Reserve Fund in fiscal 2017. It is assumed that fiscal 2018 funding will be provided as general obligation bonds in the upcoming capital budget, as has been the case in most recent years.

Fiscal 2018 also includes \$12.6 million in mandated general funds resulting from the creation of three programs through legislation passed during the 2016 legislative session (explaining about half of the increase in “Other” funding shown in Exhibit 1). Chapter 32 established the Public School Opportunities Enhancement Program, a grant program to assist local school systems, public community schools, and nonprofit organizations in the State in expanding or creating extended day and summer enhancement programs, as well as assisting nonprofit organizations in expanding or supporting existing educational programming during the school day, with \$7.5 million mandated annually for the program through fiscal 2021. Chapter 33 established the Next Generation Scholars of Maryland Program, which allows qualified students to receive college and career readiness guidance and services and pre-qualify for financial aid grants to be used at the time of enrollment in an institution of higher education, provided they meet certain requirements. A total of \$5.0 million is mandated for the program annually through fiscal 2023, with approximately \$4.9 million to be provided as grants to nonprofit organizations and public school systems to provide guidance and services to students. Lastly, Chapters 681 and 682 established a Robotics Grant Program with \$250,000 mandated annually to support public schools and nonprofit robotics clubs in maintaining existing robotics programs in the State and increasing the number of these programs.

State Retirement Costs Decline; Local Costs Increase Slightly

State retirement costs for public school teachers and other professional personnel will total an estimated \$736.4 million in fiscal 2018, representing a \$30.9 million (4.0%) decrease. This decrease is attributed to an increase in the salary base for teachers being more than offset by a decrease in the State contribution rate and a slight increase in local government contributions. Local school boards will contribute slightly (0.4%) more for the local share of retirement costs than in fiscal 2017, or approximately \$295.9 million in fiscal 2018: \$280.5 million for the local share of pension contributions as well as \$15.4 million toward State Retirement Agency administrative costs.

Chapter 1 of the first special session of 2012 phased in over four years (fiscal 2012 to 2016) the requirement that local employers pay the employer “normal cost” for active members of the

State Teachers' Pension or Retirement Systems. Fiscal 2018 is the second year in which the *actual* normal cost will be used to determine local contributions; the estimated normal cost was set in statute for each county during the fiscal 2012 to 2016 period. The normal cost for fiscal 2018 is 4.47% of salary base as compared to 4.56% in fiscal 2017; however, salary base increases in several counties result in a net increase in retirement costs for eight school systems. Chapter 1 also initiated annual teacher retirement supplemental grants totaling \$27.7 million to lower wealth counties (including Baltimore City) to help offset the impact of sharing teachers' retirement costs with the counties, beginning in fiscal 2013. In addition, Chapter 1 repealed the requirement that school systems reimburse the State for the full retirement costs of federally funded positions beginning in fiscal 2015 to help offset the impact of pension cost sharing.

Hunger-free Schools

The federal Healthy, Hunger-Free Kids Act of 2010 amended the federal National School Lunch Act to provide an alternative for high-poverty school systems and schools to provide free and reduced-price meals (FRPM) to all students in a school or system. This alternative, referred to as the Community Eligibility Provision (CEP), does not require participating school systems to collect forms certifying students' FRPM eligibility. Several schools and school systems in Maryland, including Baltimore City Public Schools, are participating in CEP. Chapter 291 of 2015 – the Hunger-Free Schools Act – altered the enrollment count used to calculate State compensatory education aid for school systems that participate, in whole or in part, in CEP by providing a floor for the FRPM count (and therefore a floor for compensatory aid) for participating school systems, but for fiscal 2017 and 2018 only. The bill also required the adequacy of education funding study to include suggested alternatives to FRPM as a proxy for identifying students requiring compensatory funding. The FRPM proxy report was completed in December 2015, but the commission that has been appointed to review school funding adequacy will not make recommendations until December 2017. In order to continue to hold school systems that are participating in CEP harmless from potential losses in compensatory education aid until the commission completes its work and subsequent legislation is considered, the sunset date for Chapter 291 must be extended beyond fiscal 2018 during the upcoming session. Due to the timing of CEP applications, legislation must be enacted prior to the beginning of fiscal 2018.

Maintenance of Effort

The Maintenance of Effort (MOE) law requires each county government (including Baltimore City) to provide as much per pupil funding for the local school board as was provided in the prior fiscal year. Beginning in fiscal 2017, the local retirement contribution for the normal cost is included in the highest local appropriation for purposes of calculating the per pupil MOE amount. As of November 2016, the Maryland State Department of Education (MSDE) has certified that the school appropriations of all 24 counties have met the fiscal 2017 MOE requirement. In total, 17 counties significantly exceeded MOE, including Baltimore City.

The fiscal 2017 State budget restricts \$10 million in disparity grant funding for Baltimore City contingent on Baltimore City appropriating for fiscal 2017 an additional \$10 million for Baltimore City Public Schools (BCPS) over the fiscal 2016 local appropriation. These funds were appropriated by Baltimore City. The city's required MOE funding for fiscal 2018 depends on whether the \$10 million is included in the MOE calculation. If a joint report on shared costs between Baltimore City and BCPS is submitted by January 15, 2017, then the full \$10 million will be included in the fiscal 2018 MOE calculation. If the report is not submitted by the due date, only \$5 million will count toward MOE. MSDE will issue a revised MOE certification statement for Baltimore City after January 15, 2017.

Finally, 10 jurisdictions may be required to increase their MOE appropriations in fiscal 2018 as required by Chapter 6 of 2012. Preliminary estimates suggest that statewide per pupil local wealth will increase slightly from fiscal 2017 to 2018. Actual wealth and enrollment figures pertaining to fiscal 2018 aid will be available in January 2017. The required increase is the lesser of the increase in a county's per pupil wealth, the average statewide increase in per pupil local wealth, or 2.5%. In fiscal 2017, 9 jurisdictions were required to increase their appropriations for the first time due to this provision, ranging from an increase of 0.2% to 2.3%.

Education

Adequacy Study and the Commission on Innovation and Excellence in Education

The consultant who studied the amount of funds necessary to provide an “adequate” education to all students in Maryland has submitted a final report. The report concluded that total education aid should increase by \$2.9 billion, with \$1.9 billion from the State and \$1 billion in local aid. The Commission on Innovation and Excellence in Education has been established to recommend funding changes as well as to study other aspects of K-12 education. The commission will make recommendations to the Governor and General Assembly by December 2017.

Commission on Innovation and Excellence in Education Begins Work

Chapter 701 of 2016 established a 25-member Commission on Innovation and Excellence in Education that, among other charges, must (1) review the findings of the consultant’s study on adequacy of education funding and its related studies and make recommendations on the funding formula; (2) review and make recommendations on expenditures of local school systems; (3) review and make recommendations on innovative education delivery mechanisms and other strategies to prepare Maryland students for the 21st century workforce and global economy; and (4) review and make recommendations on expanding prekindergarten, including special education pre-k. The commission members were appointed this summer with former University System of Maryland Chancellor Dr. William “Brit” Kirwan being appointed to serve as chair of the commission. At the time of publication, the commission has held two meetings.

At the second meeting of the commission, the National Center on Education and the Economy presented on competing with countries that lead the world in K12 education outcomes. High school students across the United States have made little progress on the National Assessment of Educational Progress (NAEP), known as the Nation’s Report Card, over the past four decades, as shown in **Exhibit 1**, while spending per pupil has increased significantly. Internationally, the United States has received disappointing results on the Programme for International Student Assessment (PISA), a comparative study of 15-year-old students’ knowledge in key subjects including math, reading, and science, since the first administration in 2000. The 2012 PISA scores were worse for the United States, which ranked twenty-fourth in reading, thirty-sixth in math, and twenty-eighth in science out of 65 countries. The National Conference of State Legislatures presented a recent report of its study group that is looking at the PISA results and what states must do to prepare their citizens for the global economy, called *No Time to Lose* http://www.ncsl.org/documents/educ/Edu_International_Final_V2.pdf.

Exhibit 1 Per Pupil Spending and NAEP 12 Grade Reading Scores 1971-2012



*Revised assessment format

Source: The Nation's Report Card, *NAEP 2012 Long-Term Trends in Academic Progress*; NCES *Digest of Education Statistics 2014*

A third meeting is scheduled for December 8, 2016, when the commission will be briefed on the final adequacy report, which is described below. The commission must submit a preliminary report to the Governor and selected committees of the General Assembly by December 31, 2016, and its final report by December 31, 2017. All meetings will be broadcast on the General Assembly website, and meeting materials will be posted shortly after the meeting concludes at: <http://mgaleg.maryland.gov/Pubs/CommTFWorkgrp/2016-Innovation-Excellence-in-Education-Commission.pdf>.

Adequacy Study by Consultant is Complete

The Bridge to Excellence in Public Schools Act (Chapter 288 of 2002), which established State education aid formulas for public schools based on the concept of adequacy (the level of resources that is necessary for all public school students to have the opportunity to achieve academic proficiency standards), required the State to contract with a consultant to conduct a

follow-up study of the adequacy of education funding in the State. The consultant, Augenblick, Palaich, and Associates (APA), was hired and began work in June 2014. A number of reports on ancillary and complementary topics of education funding have been completed and are summarized in an issue paper prepared for the 2016 session which can be found here: <http://mgaleg.maryland.gov/Pubs/LegisLegal/2016rs-Issue-Papers.pdf>.

During the 2015 and 2016 interim, APA has been working on the main component of its study: what constitutes adequate funding and what changes to the State's current funding formulas should be made to achieve adequacy. APA submitted the final report to the Governor and General Assembly on November 30, 2016. The report and all other APA studies can be found here: <http://marylandpublicschools.org/Pages/adequacystudy/index.aspx>.

Summary of the Final Report

The current funding formulas for providing State aid to local school systems are largely based on the following factors: (1) a per pupil foundation funding amount; (2) weights from which an extra per pupil amount is provided for students with special needs; (3) a regional cost adjustment; (4) enrollment; and (5) the wealth of a local school system relative to others in the State. These five factors, when considered together, lead to how much State education aid is provided to each local school system and how much education aid must be provided by the county. While APA makes recommendations for changes within each of these factors, they do not recommend abandoning this basic structure. Overall, the APA report recommends that, in order to provide adequate funding, a total increase of \$2.9 billion over fiscal 2015 is needed, with \$1.9 billion from the State and \$1.0 billion from counties (including Baltimore City). This amount does not include State teacher retirement costs.

Adequate Funding Recommendations

Base Per Pupil Foundation Amount and Special Needs Weights

The APA report recommends raising the amount of funding provided for each student to \$10,880. For a frame of reference, the foundation per pupil amount was \$6,860 in fiscal 2015 and \$6,964 in fiscal 2017. The report also recommends adjusting the current weights for special needs students as follows: (1) an additional 35% of the per pupil foundation amount for each low-income student (currently 97% is provided); (2) an additional 35% for students with limited English proficiency (currently 99%); and (3) an additional 91% for each special education student (currently 74%). In addition, the report recommends providing an additional 29% of the per pupil foundation amount for four-year-old children in full-day prekindergarten. APA is also recommending that counties should be required to provide their proportion of the cost; the current funding formula for special needs students does not require the counties to provide funding for their share of this cost.

Counting Enrollment

Currently, the number of students used to calculate total funding is the most recent actual enrollment count in each school system. Due to the timing of the budget request and approval cycle, this means that, for example, the funding for the 2016-2017 school year is based on the actual number of students enrolled in September 2015. APA recommends to instead use the higher student count of either (1) a rolling average of the three prior years or (2) the count currently used. This method will ensure that as enrollment is increasing, a school system will receive commensurate funding, but as enrollment may be decreasing, the resulting decline in funding will be softened from year to year.

Including Prekindergarten

In addition to this new method of calculating enrollment, the report recommends to start including the number of four-year-olds enrolled in a high-quality prekindergarten program as measured by the Maryland Excellence Counts in Early Learning and School-age Child Care (EXCELS) Program. Currently, these students are not counted in enrollment but an adjustment to the weight for low-income students is made to provide funding to school systems for prekindergarten services.

Regional Cost Differences

The State provides additional aid to local school systems in which the cost of providing education services is higher than in other jurisdictions. The calculation of this additional aid is called the geographic cost of education index (GCEI) and is currently calculated based on a hedonic modeling which is a statistical methodology that assigns dollar “weights” to teacher-specific and location-specific factors that determine individual teachers’ salaries. APA recommends switching to a comparable wage index (CWI), which is a more simplified calculation that focuses on (1) the wages paid to workers with similar qualification levels as teachers, but excludes wages paid to teachers; (2) worker preferences; and (3) local amenities. Currently, funding is not reduced in districts with lower than average costs, the GCEI is only applied to the foundation program, and the State pays both the State and local shares of the additional cost. APA is recommending that revenues be reduced in those counties with lower than average costs, the CWI should be applied to both the foundation program and the additional funding streams for special needs students, and local jurisdictions should pay the local share of the additional costs.

Distribution of State Aid to Local School Systems

To determine how much State aid is provided to a particular local school system, the relative wealth of a county as compared to the State as a whole is calculated. This calculation leads to more State aid being provided (and less local aid needed) for local school systems with lower than average wealth. There are several factors that impact the distribution of State aid based on this wealth calculation. The changes to these factors can greatly alter the distribution of State aid and the required local appropriation.

Net Taxable Income

APA recommends using November 1 to calculate a county's net taxable income (NTI), which is a component of calculating the wealth of a county. Currently, net taxable income is measured on both September 1 and November 1 and the greater amount of State aid that results from these two calculations is provided.

Multiplicative Calculation of Wealth

Currently, a county's wealth includes both the income of county residents (NTI) and a proportion of the assessed value of the property in the county. These two amounts are added together to calculate the overall wealth of a county. APA recommends switching to a multiplication calculation whereby each county's percent of the State average income is multiplied by each county's property wealth (the reverse calculation also yields the same result). The overall effect of this approach will exaggerate the disparities in wealth between all 24 counties and significantly alters the distribution of State aid.

Minimum State Funding Amounts

Because the amount of State aid provided to a particular local school system is dependent on the relative wealth of that jurisdiction, a county that is relatively wealthy receives less education aid from the State and more from the county. Currently, the formulas have a mechanism that guarantees that every local school system, regardless of a county's wealth, will receive a minimum of 15% of the total foundation aid from the State and a minimum of 40% of the aid for special needs students from the State. The APA report is recommending that each of these minimums, referred to as "funding floors," be eliminated.

Education

Accountability Under the Federal Every Student Succeeds Act

The federal Every Student Succeeds Act (ESSA), which replaces the No Child Left Behind Act, requires each state to submit a Consolidated State Plan that complies with ESSA to the U.S. Department of Education for review by July 2017. An external ESSA Stakeholder Committee has been meeting in 2016 to develop recommendations for Maryland's plan, which must include challenging assessments. A statutorily required commission completed its work reviewing assessments and testing in Maryland schools and submitted final recommendations in July 2016. The State Board of Education agreed with most of the recommendations, but disagreed on several key recommendations.

Federal Every Student Succeeds Act

On December 10, 2015, President Barack Obama signed into law the Every Student Succeeds Act (ESSA), a reauthorization of the Elementary and Secondary Education Act, which succeeds the No Child Left Behind Act (NCLB). Regarding accountability, whereas NCLB required a state education agency to hold schools accountable based on results on statewide assessments and one other academic indicator, ESSA requires each state to have its own accountability plan based on multiple measures, including at least one measure of school quality or student success and, at the state's discretion, a measure of student growth. The expectation is that a state's Consolidated State Plan (CSP) will be effective for the 2017-2018 school year.

Maryland's Consolidated State Plan

The ESSA requires "timely and meaningful" engagement with various stakeholders, including the Governor and legislature, in each state. In developing Maryland's CSP, the Maryland State Department of Education (MSDE) has convened an external ESSA Stakeholder Committee. The composition of the committee includes teachers, principals, local superintendents, members of the State Board of Education (SBE), policy analysts from the legislature and the Governor's Office, representatives of teachers' unions, representatives of charter schools, representatives of the business community, and representatives of the disabilities community. The group has met four times to date in 2016 in order to discuss and craft recommendations that will be made to SBE regarding components of the CSP. The committee will continue to meet until the CSP has been finalized.

A first draft of Maryland's CSP is being prepared given the input of the ESSA Stakeholder Committee and SBE received thus far, and will be posted on MSDE's website for feedback in mid-December 2016. MSDE is expecting to post a second draft in late February/early March. The committee will submit its final recommendations to SBE in the form of a draft on April 25, 2017.

This draft will again be posted and shared with stakeholders for final input. SBE must submit the CSP to the U.S. Department of Education by July 5, 2017.

Components of the CSP include (1) Consultation and Coordination; (2) Challenging Academic Standards and Assessments; (3) Accountability, Support, and Improvement for Schools; (4) Supporting Excellent Educators; and (5) Supporting All Students. ESSA requires the CSP to include an Accountability System with at least four indicators, as follows: (1) achievement and gap narrowing goals; (2) progress/growth (at the elementary/middle school level) or graduation (at the high school level); (3) English learner proficiency; and (4) school quality/student success.

Achievement and Gap Narrowing Goals

For the achievement and gap narrowing goals, a proficiency level must be set as well as a metric by which to determine long-term and interim goals for achievement and how much weight to give these values. MSDE has proposed an annual measurable objective (AMO) methodology used over a 16-year time period, which was chosen in order to ensure that the students affected have a full 12 years of implementation of the Maryland College and Career Readiness standards. In addition to setting a proficiency level and the AMO metric, the CSP may also include a measurement of improvement through an index that would provide a measurement of improvement across all performance levels on the assessment and not just on achieving proficiency.

Progress/Growth

The amount of weight to give to an indicator of progress/growth in the CSP must still be determined. MSDE has proposed two methodologies, one or both of which may be included in the indicator. The methodologies presented include (1) a value matrix and (2) a student growth percentile (SGP). The value matrix compares the performance of a student to that same student in the following year. Actual points would be determined through a standard setting process. The SGP reflects student growth by comparing a student with the student's academic peers who had similar academic performance in the previous year. In this indicator, a student may perform well *below* proficiency, but achieve a high growth percentile or improvement. In contrast, a student may perform well *above* proficiency and achieve a small growth percentile or improvement.

Assessment Requirements Under ESSA

Similar to NCLB, ESSA requires that students be tested in reading/language arts and mathematics annually in grades 3 through 8; in reading/language arts and mathematics once in high school; and in science, once in each of three specified grade spans. In Maryland, the Partnership for Assessment of Readiness for College and Careers (PARCC) is mostly used for these requirements. However, ESSA allows a state to approve a local school system's use of a nationally recognized high school test such as the SAT or the ACT instead of PARCC. The approved assessments must meet all federal and state assessment and accountability requirements. ESSA also establishes a pilot program for seven states to create an innovative assessment system

that aligns with personal learning and competency-based education; however regulations for this pilot have not yet been promulgated.

Regardless of which assessment is used, concerns have been raised by parents and teachers about the purpose, scope, and amount of testing students in Maryland are currently undergoing. Chapter 421 of 2015 established the Commission to Review Maryland's Use of Assessments and Testing in Public Schools to make recommendations on how local school systems and the State can improve the process by which assessments are administered. The commission issued a report in July 2016, and each local school system as well as SBE was required to review and provide comments on the commission's recommendations by September 1, 2016, and October 1, 2016, respectively.

The commission's report acknowledged that assessing students is an integral part of the teaching and learning process. Assessments are able to gather information that is used to guide educational decisions and to inform various stakeholders on the growth and achievement of students and student groups. The commission's 22 recommendations center around three themes: (1) assessments should be limited in number, purpose, and time; (2) the administration of assessments is a joint responsibility of MSDE and local school systems; and (3) in order to administer assessments in the most efficient way, technology must be used and technological disparities in local school systems must be addressed.

SBE agreed with the majority of the commission's recommendations; however, it departed from the recommendations of the commission in the following: (1) recommending that a middle school social studies assessment should go forward (the commission had recommended repealing the requirement); (2) the administration window for the high school government assessment should not be changed until the 2018-2019 school year (the commission had recommended the high school government assessment should be administered within class periods without needing to alter the normal school day schedule); and (3) the current practice of only allowing certificated staff to administer, proctor, and accommodate certain assessments should be maintained (the commission had recommended that restrictions on who can administer, proctor, and accommodate State and locally mandated assessments should be relaxed in order to limit the impact of subject matter testing on certificated teachers and staff in other subject areas).

Education

Executive Order Issued Setting Start and End Dates of the School Year

The Governor issued an executive order requiring public schools to open for student attendance after the Labor Day holiday and to close by June 15 beginning in the 2017-2018 school year, while minimizing the State Board of Education's authority to grant waivers from this requirement. The Attorney General has advised that the executive order may exceed the Governor's authority. Representatives of the State board and local school systems have expressed concern about the compressed timeframe created by the executive order and loss of local control over the school calendar.

Governor Orders Post-Labor Day School Start Date and June 15 End Date

On August 31, Governor Lawrence J. Hogan, Jr. announced the signing of Executive Order 01.01.2016.09 requiring, with a few exceptions, the county boards of education to open schools for student attendance no earlier than the Tuesday following the Labor Day holiday and to conclude no later than June 15 beginning in the 2017-2018 school year. County boards may apply to the State Board of Education each year for a one-year waiver from these requirements to be granted at the sole discretion of the State board based on standards for a compelling justification adopted through regulation.

At the September 27, 2016 meeting of the State board, board members expressed concerns about the executive order regarding its legal effect in light of the letter of advice from the Office of the Attorney General (OAG) (discussed below), the independence of the State board to set education policy in the State, the precedent set by the executive order on establishing education policy in the future, and the preservation of traditional local control of education in the State. The State board adopted a motion to draft guidance for local school systems to make it clear that the State board intends, "beginning immediately, to approve expeditiously requests for waivers from the calendar limits" set by the executive order and the standards for granting waivers while working through the lengthy formal regulatory process.

On October 11, 2016, the Governor issued Executive Order 01.01.2016.13, revising the waiver process by repealing the provisions granting the State board discretion in determining a compelling justification for granting a waiver and the procedures for applying for a waiver. The revisions prescribed three types of justification: (1) an innovative school schedule for certain low-performing or at-risk public schools; (2) an innovative school schedule for a charter school; and (3) local school districts that closed for 10 days per school year during any two of the last five years due to natural disaster, civil disaster, or severe weather conditions. The revised waiver application process requires a county board to submit to the State board a petition establishing the elements of an approved justification, certification of a public meeting that included consideration

of a waiver application with meeting minutes, and any additional information requested by the State board. These changes minimize the discretion of the State board in granting waivers.

Legal Implications

On September 16, 2016, OAG sent a Letter of Advice to members of the General Assembly to answer their questions as to whether the executive order is a permissible exercise of the Governor's authority and whether the General Assembly could pass legislation overriding or negating the executive order. The Attorney General advised that the General Assembly could pass legislation overriding the executive order. The answer to the question regarding the Governor's authority to issue an executive order regarding education policy is less clear.

The Attorney General advises that while the Governor has broad constitutional and statutory authority to direct actions of the Executive Branch of State Government, it is limited to the "guidelines, rules of conduct or rules of procedure" for "State employees," "units of State government," and people who are "under the jurisdiction of," or who "deal with," those employees or units or the principal departments of the Executive Branch. In the opinion of the Attorney General, the Governor does not have the power to direct educational policy or public school administration through the mechanism of an executive order due to a combination of the State board's substantial independence as a principal department of State government and its extensive visitatorial power in the setting and administration of education policy.

Structurally, the Maryland State Department of Education is designated by statute as "a principal department of *State Government*," not 1 of the 19 principal departments of the *Executive Branch*. The State Superintendent of Schools, the functional equivalent of a department secretary, is appointed and removed by the State board and does not serve at the Governor's pleasure as department secretaries do. Although members of the State board are appointed by the Governor subject to legislative approval, they may only be removed for cause as set forth in statute and also do not serve at the Governor's pleasure. Furthermore, the duty to provide for a public education system in Maryland is constitutionally assigned to the General Assembly under Article VIII, § 1, not the Governor. The legislature has delegated to the State board its constitutional power to implement the public school system in Maryland. The Court of Appeals has determined that the State board's administrative powers are "summary and exclusive" and constitute the "last word" on education policy.

The Attorney General also advises that the determination of the school calendar likely constitutes a matter of educational policy subject to the State board's broad and comprehensive visitatorial power. Although the school calendar affects more than the quality of education a student receives, beginning school after Labor Day does have an impact on educational outcomes and certainly affects the administration of the public school system. Maryland's appellate courts, in a case involving collective bargaining, have determined that the school calendar has a significant bearing on the administration of public schools and, thus, falls within the State board's authority to set educational policy.

Therefore, since the State board is not a principal department of the Executive Branch and the school calendar is likely a matter of educational policy, the Attorney General determined that while he “cannot say unequivocally that the Labor Day executive order exceeds the Governor’s authority...[he] believe[s] it likely that a reviewing court, if presented with the issue, would conclude that it does.” Further, OAG indicates that the revised executive order would make it more likely that a reviewing court would find that it exceeds the Governor’s authority.

Current School Calendars

Factors Influencing School Calendars

State law establishes the length of the school year, requiring public schools to be open for pupil attendance for at least 180 days and 1,080 hours during a 10-month period. County boards determine the school calendar each year, and each local school system has a calendar planning committee that considers various factors including testing dates, mandated holidays, and negotiated agreements, including teacher work days and professional development days. Additional constraints on setting a calendar include the following: (1) State regulations that establish a calendar for interscholastic athletic contests and practice sessions; (2) larger local school systems with diverse student populations may consider closing schools in observance of various religious holidays; (3) when holidays fall on different days of the week each year, certain years are more difficult to plan; and (4) standardized testing dates are set on dates by entities outside the control of a local school system.

Teacher Work Days and Professional Development

Teacher work days and professional development training sessions are also considered in developing a local school system’s school calendar. There is no State law or regulation requiring a specified number of days or hours. Consequently, the number of these days is a local issue negotiated in the local collective bargaining agreement. A survey of the 2016-2017 school calendars for the 24 local school systems shows that the number of teacher work days and professional development days throughout the school year varies significantly. The number of such days is as low as 2 in Anne Arundel and Worcester counties to as many as 11 days in Frederick, Kent, and Queen Anne’s counties. Each county builds these days into the calendar differently. Some counties devote an entire school day, some only use early dismissal days, and other counties use both.

Waivers from the Required Number of School Days

Under State law, county boards may request a waiver from the 180-school day requirement from the State board under specified circumstances, including a natural disaster, civil disaster, or severe weather conditions. In terms of weather-related waivers, the Maryland State Department of Education provided a five-year history of waiver requests. Each county board builds in a number of inclement weather days into the school calendar each year. The State board determines

the number of days for which it will consider granting a request for waiver. For the remaining days, a county board is required to make up for the missed days elsewhere in the school calendar.

In a year of challenging weather, such as 2013-2014, many schools closed for inclement weather for more than twice the number of budgeted days. For example, Montgomery County budgeted 4 days and used 10 days and Garrett County budgeted 8 days but used 20 days. The State board granted each county's request for a waiver. In a mild weather year such as the 2015-2016 school year, 17 counties did not request a waiver. Baltimore City requested 4 days but was denied by the State board. Overall, under the revised executive order's parameters for inclement weather, 7 counties were closed for at least 10 days in any two of the prior five years.

School Start and End Dates

School start and end dates for student attendance vary among the local school systems throughout the State, with the vast majority choosing to start school one to two weeks before Labor Day. Worcester County is now the only local school system to start school after the Labor Day holiday. This is a decrease from a high of six school systems (Baltimore City and Baltimore, Harford, Montgomery, Wicomico, and Worcester counties) in 2000. For the 2016-2017 school year, school began as early as August 17. School end dates also vary significantly across the State. For the 2015-2016 school year, school ended as early as June 1 and as late as June 21.

School Calendar Options

When the first executive order was issued, many local school systems were in the midst of planning or finalizing the 2017-2018 school calendar. Representatives of various school systems expressed concern with the compressed timeframe; including all 180 school days in a reduced 9 ½-month period from the statutory 10-month period. Each county board is reviewing options for planning the next school calendar in light of the Governor's executive order. Some potential options may include adjusting the current calendar days by altering nonmandated holidays and school breaks, altering professional development days, requesting a waiver from the State board if the county meets the requirements for a justification, and choosing not to comply in light of the uncertain legal basis for issuance.

Education

21st Century School Facilities Commission and Public School Construction

The 21st Century School Facilities Commission has met during the 2016 interim; the commission will present recommendations for the 2017 session and will continue its work in the 2017 interim. In fiscal 2017, the Governor and Comptroller withheld \$15 million in school construction funding from Baltimore City and Baltimore County until each school system developed plans to air condition every school by fall 2017. To date, none of the funds have been released. The Governor's preliminary school construction allocation is \$320 million for fiscal 2018. The Interagency Committee on School Construction (IAC) will make initial recommendations to the Board of Public Works in December 2016. Budget language included in the fiscal 2017 capital budget states that for fiscal 2018 the recommendations of IAC are not subject to further appeal.

21st Century School Facilities Commission

The 21st Century School Facilities Commission was appointed by the President of the Senate and the Speaker of the House of Delegates in early 2016 to, among other things, review public school construction processes, construction practices, and educational specifications to determine whether they are meeting the needs of 21st century schools. The commission, chaired by Mr. Martin G. Knott Jr., includes legislators, Interagency Committee on School Construction (IAC) members, local school system and government officials, and representatives of the private sector. The commission has been meeting throughout the 2016 interim and has focused on using alternative procurement methods, construction materials, and innovative designs for schools. The functions of IAC and whether the organization and the school construction project approval process could be improved in order to better serve Maryland public schools and students were also primary topics during the 2016 interim. The commission is also reviewing the roles of the State agencies and local school systems involved in the school construction process to reduce unnecessary overlap and inefficiency. The commission will make interim recommendations in December 2016 for the upcoming session and will continue its work in the 2017 interim.

School Construction Funding and Maintenance

The Governor submitted a preliminary school construction allocation of \$320 million in the fiscal 2018 budget, the same as the new funds allocated in fiscal 2017, which includes \$40.0 million for specific counties with high enrollment growth or relocatable classrooms. Maryland school systems have requested \$671.5 million in school construction funding for fiscal 2018. In early December 2016, IAC will hold appeals hearings on the initial allocation of 75% of the \$320 million in school construction projects and will then make final recommendations to the Board of Public Works (BPW) for approval in January 2017. Budget language was included

in the fiscal 2017 capital budget, which stated that for fiscal 2018 the recommendations of IAC are not subject to further appeal.

Air Conditioning

Fiscal 2017 capital budget language states that the Public School Construction Program would operate in accordance with the regulations in place as of January 1, 2016. Under those requirements, all State-funded eligible expenditures must have a life expectancy of 15 years or more. Over the last year, there has been much debate over changing regulations to make window air conditioning (AC) units, which have a useful life of less than 10 years, eligible for capital funding in order to protect the health and wellbeing of students. Currently, 9% of schools in the State do not have central AC, with especially large numbers in Baltimore and Garrett counties, as well as Baltimore City. The Department of General Services has determined that addressing the need for AC through window units would require \$9.5 million in State funding. BPW approved a regulation to make window AC units eligible for capital funding, which will apply to projects beginning in fiscal 2018. Approval of funding for window AC units is still subject to the same process for approval as all other Public School Construction Program projects, requiring recommendation by IAC and approval by BPW. However, to date, no window AC projects have been requested.

At BPW's May 11, 2016 meeting, the Governor and Comptroller voted to withhold \$10 million from Baltimore County and \$5 million from Baltimore City's fiscal 2017 allocation until a plan was submitted by each jurisdiction to air condition all classrooms by fall 2017. Baltimore County accelerated its schedule, so that all schools would be air conditioned by August 2018. In order to meet this accelerated schedule, IAC approved a request to allow early solicitation of bids for 12 systemic renovation projects. BPW has not released any money that has been withheld, and it has not identified the specific projects from which the funds are being withheld.

School Maintenance Reports

For at least the last five years, IAC has been behind on submitting annual maintenance reports. While approximately 200 schools were inspected annually, the time to produce the annual reports was not prioritized. On October 1, 2016, the fiscal 2015 and 2016 annual reports were submitted to the General Assembly and restricted funds in the budget were then released. IAC has decided to change its methodology and focus less on jurisdictions receiving a high number of superior and good results, devoting more resources to those jurisdictions producing less satisfactory results. The same number of inspections, 220 inspections, is scheduled for fiscal 2017.

Baltimore City School Construction and Revitalization

Baltimore City Public Schools (BCPS) has the oldest school buildings in the State. A 2012 assessment of the condition of BCPS facilities by a consultant hired by the Baltimore City

Board of School Commissioners estimated a cost of \$2.4 billion to address the educational adequacy, condition, and life-cycle needs of the facilities. In response to this critical need for public school facility improvements in Baltimore City, Chapter 647 of 2013 (Baltimore City Public Schools Construction and Revitalization Act) established a new partnership among the State, Baltimore City, and BCPS to fund up to \$1.1 billion in public school facility improvements through revenue bonds to be issued by the Maryland Stadium Authority.

The current estimate is that 23 to 28 schools will be replaced or renovated. The specific projects that will be included in the initiative contain more elementary and middle schools and fewer high schools than originally proposed. The schedule has taken longer than anticipated, with the first 2 schools now expected to open in summer 2017. To date, one bond issuance of \$320.0 million was issued on April 20, 2016, resulting in \$385.0 million available for construction. As of June 30, 2016, 10 schools are under construction, there is a cash balance of \$53.9 million, and a bond proceeds balance of \$369.1 million ready to be spent.

IAC has had continued concerns with the BCPS operating budget. With the first schools opening in summer 2017, BCPS will need to find additional funds when the new schools are opened. The Memorandum of Understanding states that BCPS must include an annual increase over the prior year maintenance appropriation of \$3 million; Baltimore City budget cuts have left only \$2 million for fiscal 2017. The BCPS budget will continue to be a critical issue to monitor.

As required by law, the board set a systemwide utilization goal of 86% by fiscal 2020, with an intermediate goal of 80% by fiscal 2016. BCPS met its intermediate goal with a district utilization of 83% in school year 2015-2016, though it only did so by not including swing space, *i.e.*, the school buildings that are set aside to house students on a temporary basis during construction of their home school. When swing space is included for fiscal 2016, BCPS achieved a 77% utilization rate. From the perspective of counting only the utilization of each school, this is valid; yet from the perspective of the real effect of capacity on the operating budget, this overlooks the huge burden that is associated with the swing space. If swing space is included in the calculation, BCPS states that it will only reach 84% utilization by fiscal 2025, missing the fiscal 2020 goal.

Education

Alternatives to the Traditional Public School Model

Four alternatives to the traditional public school model were implemented or studied in Maryland in 2016. Students began attending the first Pathways in Technology Early College High Schools in Maryland, and over 2,000 students were awarded scholarships to attend nonpublic schools. Additionally, a study related to determining commensurate funding for charter schools was conducted, and a study to determine the feasibility of establishing an adult high school in Maryland is still underway.

In 2016, four alternatives to the traditional public school model were implemented or studied in Maryland. The first two Pathways in Technology Early College High (P-TECH) Schools opened in the 2016-2017 school year, and scholarships for students to attend nonpublic schools were awarded for the first time for the 2016-2017 school year. A study related to determining commensurate funding for charter schools was conducted, and a task force is studying the feasibility of establishing an adult high school in the State.

P-TECH Schools

Chapter 144 of 2016 established P-TECH Schools in Maryland, which are public schools that offer grades 9 through 14 and that integrate high school, college, and the workplace. The result is a seamless pathway that enables students to graduate in six years or less with a high school diploma, an associate's degree or certificate, and relevant professional experience. One of the goals of P-TECH schools, which distinguishes them from other early college programs, is for students to earn a credential and workplace skills that are aligned with industry needs and expectations. Other hallmarks of the P-TECH program are open admission and no cost to students.

The first P-TECH schools in Maryland opened for students in Baltimore City in the 2016-2017 school year with 50 ninth grade students at Paul Laurence Dunbar High School and 50 ninth grade students at Carver Vocational-Technical High School. P-TECH at Dunbar is a partnership with Johns Hopkins Hospital; University of Maryland, Baltimore; and Kaiser Permanente. P-TECH at Carver is a partnership with IBM. Four additional P-TECH schools are projected to open with approximately 20 ninth grade students in each school in the 2017-2018 school year, with one school in Allegany County, one school on the Upper Eastern Shore, and two schools in Prince George's County. Planning grants totaling \$600,000 were distributed for all six schools in fiscal 2016.

Chapter 144 only authorized the first two schools opening in the 2016-2017 school year to receive additional State aid. The fiscal 2017 budget included operating funds for the two P-TECH schools in Baltimore City in addition to the Bridge to Excellence funding provided for all students

under existing law. Additional legislation will be needed in the 2017 session to expand State-supported P-TECH schools in accordance with the planning grants.

Chapter 144 charged a P-TECH stakeholders workgroup with determining the optimal structure and funding strategy for P-TECH schools in Maryland and required a report to be submitted by December 1, 2016. The P-TECH workgroup met three times and made draft recommendations in November 2016. Draft recommendations for funding P-TECH schools include two options, both of which include full-time equivalent student funding through the community college funding formulas for all six years of the program based on the number of college credits a P-TECH student enrolls in each year. The first option includes full per pupil funding through the State K-12 education aid formulas for all six years of the program, regardless of the number of college credits in which a student is enrolled. The second option includes per pupil funding through the State K-12 education aid formulas only for the fifth and sixth years of the program based on the number of high school credits in which the P-TECH student is enrolled. In addition, the first option includes an increase in the State P-TECH grant from \$520 to \$1,500 per student and *full* tuition and fee costs paid by the State, while the second option includes a \$1,500 State P-TECH grant per student and *half* of tuition and fee costs paid by the State. However, the workgroup's draft recommendations do not specify the exact mechanism for payment of the tuition and fee costs by the State.

Additional observations of the workgroup include a preference for the first funding option because it complies with the P-TECH program hallmark of covering all of a student's program costs, limiting the planning grants to the initial six schools rather than expanding to additional schools, not recommending tuition waivers for P-TECH students, and not recommending lobbying the federal government to allow P-TECH students to use Pell Grants before obtaining a high school diploma because of concerns of a disproportionate effect on low-income students.

Scholarships for Students to Attend Nonpublic Schools

The fiscal 2017 budget bill authorized the Broadening Options and Opportunities for Students Today (BOOST) Program, which provides scholarships for students to attend nonpublic schools. The budget bill directed \$4.85 million from the Cigarette Restitution Fund to be used for BOOST scholarships, and the Maryland State Department of Education (MSDE) is administering BOOST for the first time in the 2016-2017 school year. Budget bill language required scholarship recipients to be eligible for free and reduced-priced meals (FRPM) and specified that the final determinations for scholarship amounts and recipients shall be determined by a BOOST Advisory Board.

In August 2016, the board made determinations regarding the students that would be awarded scholarships and the amount of the awards. The board based its determinations on two qualifying factors: whether a student qualified for free meals or reduced-priced meals under the FRPM criteria, and whether that student attended a public or private school during the 2015-2016 school year. In the initial round, the board awarded scholarships to all applicants who qualified for free meals, all applicants who qualified for reduced-priced meals and had attended

public school during the 2015-2016 school year, and a limited number of applicants who qualified for reduced-priced meals and had attended private school during the 2015-2016 school year. Additional awards were made from a waitlist due to funds being available from initial round applicants who declined awards. **Exhibit 1** shows the priority order and amounts for scholarships awarded and accepted by recipients as of October 14, 2016. MSDE is continuing to process BOOST payments and has provided each nonpublic school with a list of its BOOST students from the initial round and the waitlist awards.

Exhibit 1
BOOST Scholarships Awarded and Accepted
As of October 14, 2016

<u>Category of Students</u>	<u>Number of Students</u>	<u>Scholarship Amount per Category</u>	<u>Total Value of Scholarship Awards</u>
Qualified for Free Meals, Attended Public School in 2015-2016	384	\$4,400	\$1,689,600
Qualified for Free Meals, Attended Private School in 2015-2016	1,504	1,400	2,105,600
Qualified for Reduced-priced Meals, Attended Public School in 2015-2016	165	3,400	561,000
Qualified for Reduced-priced Meals, Attended Private School in 2015-2016	394	1,000	394,000
Total	2,447		\$4,750,200

BOOST: Broadening Options and Opportunities for Students Today

Note: In some cases, a student’s award may vary from the set award amounts as determined by the BOOST board. For example, foster children are eligible for the highest award amount, and families who owe a tuition level that is lower than the BOOST award amount will receive funds only up to the amount of tuition owed.

In a letter submitted October 25, 2016, to the Governor, Senate President, and Speaker of the House, the board identified issues for consideration and recommendations for the BOOST program if it is to be continued. These include the following:

- soliciting applications and setting submission deadlines earlier to allow the BOOST administration to comport with the timetables for application and admission to nonpublic schools;
- a more robust evaluation of family financial need beyond FRPM that includes other financial aid being received and family contributions to the cost of education;

- clearly identified program priorities, potentially addressing issues beyond broadening nonpublic school enrollment such as prioritizing critical grade levels, differentiating by age, recognizing geographic cost disparities, requiring family contributions, and capping the number or value of awards per family; and
- more consideration of the impact of the program on nonpublic schools, especially in regard to clarifying the requirement to administer assessments according to federal and State law.

Charter Schools

Public charter schools are public schools that typically have more autonomy over their mission, program, and type of students served than traditional public schools. As of the 2016-2017 school year, Maryland has 49 public charter schools in five local school systems: Anne Arundel, Frederick, Prince George's, and St. Mary's counties and Baltimore City. State law requires that the funding provided to public charter schools be "commensurate" with the amount of funds disbursed to a traditional public school in the local school system in which the public charter school operates. The State Board of Education has established a funding model by which "commensurate" is interpreted to mean that each public charter school receives, per student, funding equal to the total annual school system operating budget divided by the total number of students in the school system, less 2% for central office administrative functions. However, due to the use of restricted federal funds and the provision of in-kind services and other contractual considerations, this funding model has not been implemented consistently across jurisdictions, nor has it been implemented without controversy.

In addition to other policy changes made to the Maryland Public Charter School Program, Chapter 311 of 2015 required MSDE, in consultation with the Department of Legislative Services, to contract for a study to calculate the average operating expenditures by each local school system for students enrolled in a traditional public school. The calculation is intended to serve as the baseline for determining commensurate funding based on school-level spending for *all* public schools.

The American Institutes for Research (AIR), the consultant selected to conduct the study, began work in spring 2016. The purpose of the study was to develop a comprehensive measure of operational spending by local school systems that reveals (1) spending on centralized services provided to schools by the central office; (2) site-specific spending for schools; and (3) spending supporting central office functions. Thus, a total spending amount per pupil at the school level was calculated for all public schools in Maryland, which includes site-specific spending and centralized spending made on behalf of all public schools. As part of the study, AIR was also required to review the arrangements made by public charter schools to secure management services and facilities, the in-kind services provided by local school systems, revenue sources used to support public charter schools, and various approaches that charters can use to finance facilities.

The study was statutorily required to be completed by October 31, 2016. In a draft version of the study, AIR makes the following recommendations:

- synchronize and align public charter school financial reporting with that of the local school systems, and include the reporting of administrative expenses and management fees, as well as occupancy-related costs;
- develop a uniform statewide school-site reporting approach for annually collecting, reporting, and analyzing school-level spending;
- set benchmarks for administrative overhead expenses for public charter schools that are based on the local school system spending rates;
- require justification of charter school management fees, detailed financial reporting of services provided by management companies to public charter schools, and the associated costs of these services;
- use a predicted expense model for guiding formula funding levels for existing and future charter schools and evaluating funding across both traditional and public charter schools; and
- establish benchmarks for public charter school occupancy costs based on a local school system's occupancy expenses.

Adult High School

Fueled by concerns that many individuals in the Baltimore City area lack the basic literacy and numeracy skills necessary for meaningful employment, the Opportunity Collaborative developed a comprehensive plan to promote the economic well-being of the region's low-skilled adult population by increasing access to education through adult high school programs from across the country. An adult high school is a school facility with a program structured to assist adult students in completing a secondary education curriculum, distinct from a general equivalency diploma program, and attaining job, social, and life skills to aid individuals in obtaining and retaining meaningful employment.

Chapter 244 of 2016 established the Task Force to Study the Adult High School Concept to study the feasibility of establishing an adult high school in Maryland. The task force is required to study and identify best practices in the development of an adult high school in areas such as operator standards, accreditation requirements, matriculation requirements, curriculum content and assessments, funding requirements, and other relevant issues, including wraparound services and online services. The study is currently underway, and on August 4, 2016, the task force conducted a site visit to two adult high schools in Washington, DC: the Carlos Rosario

International Public Charter School and the Academy of Hope Adult Public Charter School. These schools provided an example of adult high schools serving different populations, connection to wraparound services, student population size, funding sources, and operator accountability. The task force is expected to review successful model programs in other jurisdictions as well, including the Excel Center in Indianapolis. The task force is required to submit an interim report on December 15, 2016, and a final report on June 30, 2017.

Education

The Burden of Proof in Special Education Due Process Hearings

Students with disabilities are guaranteed a free appropriate public education under the federal Individuals with Disabilities Education Act (IDEA) in accordance with an individualized education program. When parents believe that their child has been denied this right, the IDEA authorizes the parents to request a due process hearing. However, in Maryland the burden of proof in these hearings falls to the party seeking relief – typically the parents. Legislation to place this burden explicitly on local school systems has been repeatedly introduced, but has not passed.

Individuals with Disabilities Education Act Due Process Hearings

The federal Individuals with Disabilities Education Act (IDEA) is a set of laws that ensures that students with disabilities are provided with a free appropriate public education (FAPE) in the least restrictive environment possible, in accordance with an individualized education program (IEP). The IDEA allows parents who believe their child is not receiving FAPE to request a due process hearing to litigate any disagreements between the parents and the public agency, which in Maryland includes the local school system and the Maryland State Department of Education. The IDEA is silent regarding who bears the burden of proof in these proceedings.

Burden of Proof as Defined Under *Schaffer v. Weast*

The U.S. Supreme Court addressed the issue of burden of proof in special education due process hearings under the IDEA in its 2005 decision, *Schaffer v. Weast*, 546 U.S. 49 (2005). In *Schaffer*, the Supreme Court noted that the burden of proof has historically been defined as “two distinct burdens: the ‘burden of persuasion,’ *i.e.*, which party loses if the evidence is closely balanced, and the ‘burden of production,’ *i.e.*, which party bears the obligation to come forward with the evidence at different points in the proceeding.” However, the Supreme Court decided to limit its discussion to the burden of persuasion and stated that when it referred to the “burden of proof,” it was referring only to the burden of persuasion. The *Schaffer* court held that “[t]he burden of proof in an administrative hearing challenging an IEP is properly placed upon the party seeking the relief.” This is consistent with the standard default rule of evidence for a plaintiff in a case in which the law is silent.

Placing the Burden of Proof on the Public Agency

In *Schaffer*, the Supreme Court declined to rule on whether a state may override the default rule, though it noted that several states “have laws or regulations purporting to do so, at least under some circumstances.” After the *Schaffer* decision, there was concern that state laws that place the burden of proof on the public agency would be preempted; however, many federal district and circuit courts have upheld the validity of state laws that allocate the burden of proof differently than was established in *Schaffer*. As illustrated in **Exhibit 1**, seven states and the District of Columbia have effectively overridden *Schaffer* by expressly putting in statute or regulation the burden of proof on the public agency in some or all instances.

Exhibit 1 Summary of Other State Statutes and Regulations That Have Effectively Overridden *Schaffer v. Weast*

<u>State</u>	<u>Summary of Statute or Regulation</u>
Connecticut	The party seeking relief has the burden of going forward with the evidence. However, in all cases, the public agency has the burden of proving the appropriateness of the child’s program or placement.
Delaware	The public agency has the burden of proof and persuasion.
District of Columbia	The party seeking relief has the burden of production and burden of persuasion except where: <ul style="list-style-type: none"> • there is a dispute about the appropriateness of the child’s program or placement; or • a parent seeks tuition reimbursement for a unilateral parental placement.
Florida	The public agency has the burden of proof in expedited hearings.
Georgia	The party seeking relief has the burden of persuasion. However, the hearing officer retains the discretion to modify this general principle.
Nevada	The public agency has the burden of proof and production.
New Jersey	The public agency has the burden of proof and production.
New York	The public agency has the burden of proof, including the burden of persuasion and burden of production, except when a parent seeks tuition reimbursement for a unilateral parental placement.

Note: Florida places the burden of proof on the public agency in a limited circumstance. The remainder of Florida law is silent as to the burden of proof. Accordingly, it can be assumed that the burden of proof is on the party seeking relief in all other circumstances.

Source: Various state statutes; Department of Legislative Services

Burden of Proof in Maryland

Maryland statutory law is silent regarding which party has the burden of proof in special education due process hearings. Accordingly, Maryland follows the holding of *Schaffer*, which arose out of a case in Montgomery County. During the 2013 session, legislation was proposed that would have placed the burden of proof on a public agency. Advocates for the bill argued that it is unfair to place the burden on parents, especially those who do not have the financial means to hire an attorney to navigate the special education hearing process. These advocates believe that public agencies are in a better position to defend the appropriateness of an IEP because public agencies have more access to documentation to prove or disprove a case. Advocates for the public agencies argued in favor of keeping the burden of proof on the party seeking relief because there are procedural safeguards built into the IDEA as well as Maryland law that give parents the right to review all records that the school has in relation to their child, among other protections. Additionally, advocates for the public agencies asserted that if due process claims increased due to placing the burden of proof on public agencies, this could result in increased general fund expenditures as well as possibly imposing a financial mandate on local government. Ultimately, the General Assembly chose not to go forward with the legislation, believing more research was necessary to determine what effect placing the burden of proof on local school systems would have on students with disabilities and local school systems.

Concurrently, the General Assembly established the Commission on Special Education Access and Equity during the 2013 session to study the extent to which parents know their rights under the IDEA and State law and regulations relating to children with disabilities and potential ways to improve the awareness of these rights. Though not part of its initial charge, the commission looked at equity between the parties in special education due process hearings and potential methods for improving the process. In its recommendations, the commission affirmatively chose not to recommend placing the burden of proof on a public agency.

In subsequent years, legislation on this topic continued to be introduced. In 2014, the 2013 legislation was reintroduced. In 2015, similar legislation was introduced; however, if a parent seeks tuition reimbursement for a unilateral placement of a student by the parent, the burden of proof in those hearings would have been on the parent. In 2016, legislation was proposed that would have required parental consent to certain aspects of a child's IEP. If the local school system did not receive parental consent, the local school system would have been required to file a due process complaint, effectively shifting the burden of proof to a public agency in these specified cases. Similar to the outcome of the 2013 legislation, the General Assembly chose not to go forward with any of these legislative proposals.

Higher Education

Study of Baltimore City Community College

A comprehensive study of Baltimore City Community College (BCCC) was completed during the 2016 interim. Most notably, the report recommends moving BCCC under the governance structure of the University System of Maryland. While BCCC strongly disagreed that changing its governance structure was necessary to improve institutional performance and student outcomes, it did generally agree with the other recommendations.

Budget Committees Request Comprehensive Review

Baltimore City Community College (BCCC) is Maryland's only State-run two-year institution and primarily serves Baltimore City residents. In recent years, BCCC has struggled with several challenges, including five presidents since 2002, enrollment declines larger than those at other Maryland community colleges, and three accreditation issues raised since 2004. These events have hindered BCCC's ability to effectively fulfill its mission.

The fiscal 2016 operating budget bill (Chapter 310 of 2015) restricted \$0.5 million from BCCC's State support for the purpose of hiring an outside consultant to perform a comprehensive review of the college's operations, including the budget and financial management, academic programs, personnel needs, and other pertinent subjects as determined by the research team. While BCCC did notify the budget committees that it had selected the Schaefer Center for Public Policy at the University of Baltimore as the consultant in November 2015, there was not enough time remaining to complete the report in fiscal 2016. Funds restricted pending the receipt of the report were released and new budget bill language in the fiscal 2017 budget bill (Chapter 143 of 2016) withheld \$50,000 in general funds until BCCC submitted the comprehensive report on the college's operations and another \$50,000 in general funds until BCCC submitted a response to that report.

Consultant's Report on BCCC

The comprehensive report from the Schaefer Center, titled *Baltimore City Community College: Tapping into Unrealized Potential to Change Lives*, was received in August 2016. With appendices, the report is over 200 pages long and fulfills the comprehensive criteria for review set forth in the budget bill language. To write the report, the research team interviewed 91 internal and external stakeholders; distributed nearly 12,000 surveys to faculty, staff, and students; and reviewed financial and legal documents. The BCCC administration was an active and supportive partner in this process.

The report begins its discussion with the observation that “the importance of BCCC cannot be overstated” for Baltimore City residents, as it is the local institution for individuals looking for in-demand workforce training and quality associates degrees. However, the report found that there is a lack of strong leadership, a lack of accountability, and ineffective and inefficient use of resources across the college. The extensive review generated 13 key findings related to the college:

1. BCCC’s success is critical to the economic future of Baltimore City;
2. the governance structure does not support the institution’s success;
3. leadership turnover has created systemic problems;
4. finances are unsustainable;
5. BCCC has failed to adjust its personnel levels to match the decline in enrollment;
6. transparency and accountability have not been characteristics of the institution;
7. academic offerings are aligned with local employment demand, but most students are not enrolled in these areas;
8. student enrollment is concentrated in general studies, and students enrolled in this area are not successful;
9. academic quality is uneven;
10. engaging in a clearer focus on offerings in workforce development and noncredit programs is an opportunity;
11. technological infrastructure is outdated and impedes the college’s effectiveness;
12. branding and marketing of BCCC is needed; and
13. the condition of the Bard Building (a vacant and deteriorating former academic building owned by BCCC in downtown Baltimore) is detrimental to the reputation of BCCC, and redevelopment of the downtown property represents a significant opportunity.

Other than findings 1 and 10, the findings generally cite specific shortcomings at the institution. Some of the supporting information for these findings is highly critical of BCCC, such as the response that many external stakeholders consider the college “disconnected and irrelevant” to the city’s economy and that “few employers know about the college.” While BCCC could be a vital resource for the city and its employers, “at the present time, however, BCCC is not fulfilling the role that Baltimore City needs.” Some of these findings have been highlighted in prior budget analyses of the Department of Legislative Services, such as uneven academic quality, misaligned financial planning, and leadership turnover.

To remedy these findings, the consultant's report proposed 12 recommendations of varying scope and cost. These include recommendations that BCCC should:

1. join the University System of Maryland (USM);
2. convert the Board of Trustees to a Board of Visitors;
3. implement transformational leadership;
4. strategically focus its course offerings;
5. make workforce development a top educational priority;
6. focus on linking noncredit students to credit programs;
7. align its budget with realistic enrollment projections;
8. engage in a top-down review of positions and staff;
9. find ways to forge meaningful relationships with key constituencies and partners;
10. rebuild its brand;
11. address its information technology needs; and
12. develop the Bard property to support BCCC.

The first recommendation is the most dramatic, as it would have BCCC join USM. This would be a significant change from BCCC's current status as an independent State agency, which it has been since 1992. The report highlights USM's expertise in oversight and advocacy of its own member institutions and community ties to the Baltimore region. This change moves in tandem with recommendation 2, which would also transform BCCC's Board of Trustees into a Board of Visitors. The remaining recommendations directly follow from specific findings, such as the need to align the operating budget with expected student enrollment. The college must also rebuild its brand, which is harmed by the vacant and deteriorating Bard Building in downtown Baltimore. The conclusion of the report reiterates that BCCC is on an unsustainable financial path and its governance structure has left the institution without effective advocacy, support, or accountability.

BCCC's Response to the Consultant's Report

In October 2016, BCCC submitted a response to the findings and recommendations contained in the consultant's report. To begin, BCCC points out that it is hindered by decisions made by previous presidents and that no other institution in the State operates as both a higher education institution and a State agency, which leads to a burdensome dual set of rules that only BCCC must follow. Overall, BCCC disagreed with findings 2 and 9 and agreed in whole or in part with the remaining findings. On the recommendations, the institution disagreed with the first two recommendations and agreed with the remaining recommendations. In its response, BCCC asserts that USM lacks expertise in BCCC's mission, curriculum, and student population, as it is distinctly unlike current USM institutions. Because it does not support joining USM, it does not find cause to alter the structure of its governance board. However, BCCC suggests that it is open to expanding its board's membership from 9 to 15 members to include representation from the Baltimore City Mayor's Office, the Baltimore City Public School System (BCPSS), and the nonprofit sector.

Where BCCC agrees with the recommendations, it has created a timeline with short- and long-term objectives for the institution to work toward. BCCC suggests a new strategy to massively scale up partnerships with BCPSS and Coppin State University (CSU) to create academic pathways from pre-kindergarten through college. Under this framework, BCCC could work more with high schools to address developmental needs and demand for dual enrollment opportunities and then to enroll lower division students on behalf of CSU, while CSU focuses on upper division and graduate coursework. Also, CSU could administratively support BCCC with its existing information technology (IT) system and free BCCC from the lengthy process of upgrading its own outdated IT systems. BCCC indicates it is pursuing negotiations with BCPSS and CSU, although nothing formal has been agreed to yet.

A joint hearing of the budget committees was held in November 2016 to hear from the consultants, the college, and the USM Chancellor. Legislators issued follow-up requests for more information from the consultant on certain measurements of the college and expressed intent to make improving management and outcomes at BCCC a focus in the 2017 legislative session.

Higher Education

Improving College Affordability

Key provisions of the College Affordability Act of 2016 will be implemented beginning in fiscal 2018 to help students and families save for college and pay off student loans. The law also incentivizes students receiving need-based financial aid to enroll in and complete 30 credits each academic year so that they graduate on time, which makes college more affordable by avoiding additional tuition costs and also freeing up financial aid awards for additional students. The law also requires a financial aid study to be completed by October 1, 2017, but the Governor did not release the \$250,000 in restricted general funds for the study in fiscal 2017. In addition, legislative subcommittees are studying the possibility of a “Promise” scholarship that provides free community college tuition to recent high school graduates. A study is also underway to examine the feasibility of establishing a Maryland student loan refinancing authority.

The College Affordability Act of 2016

The College Affordability Act of 2016 (Chapters 689 and 690) established several new programs to improve the affordability of higher education in Maryland. To help students and families save for college, Maryland 529 (formerly the College Savings Plans of Maryland) will manage a new contribution program that will match up to \$250 for eligible new 529 plan account holders beginning January 1, 2017. The program begins with \$5 million in fiscal 2018 and phases up to full funding of \$10 million annually in fiscal 2020. Maryland 529 has developed a marketing plan to make Marylanders aware of the new State matching program using new partnerships with the Maryland Head Start Association and Maryland public libraries. A second marketing plan is focused on increasing participation in 529 plans by State employees and families of students in local school systems with low 529 plan participation rates. Maryland 529 must report by December 1, 2017, on whether the matching program and new marketing plans have been effective in reaching low-income families.

To encourage current students to stay on track for college graduation, the State’s largest need-based aid program, the Delegate Howard P. Rawlings Educational Excellence Awards (EEA), will prorate awards beginning in a student’s third academic year, based on how many credits a student *completed* in the previous academic year. For example, a student enrolling and completing at least 30 credits per year is considered on-time and would receive a full award in the next year. This will first take effect in the 2018-2019 academic year. The delayed effective date provides additional time for the Maryland Higher Education Commission (MHEC) to determine how to implement the change. The law requires MHEC, in consultation with the Department of Legislative Services (DLS), to retain a consultant to conduct a study of its Office of Student Financial Assistance (OSFA), which manages the State’s financial aid programs. The General Assembly restricted \$250,000 in general funds for this purpose in fiscal 2017, but the

funding was not released by the Governor. To date, no progress has been made on this report. It is due October 1, 2017.

To assist Marylanders with student loan debt, beginning in tax year 2017, the State will award a total of \$5 million annually in refundable tax credits of up to \$5,000 per person. Qualifying students must have incurred at least \$20,000 in undergraduate debt and have at least \$5,000 of debt remaining. MHEC was required to develop a marketing plan to make graduates aware of this opportunity, which will target the State Board of Tax Preparers and the Maryland Board of Public Accountancy.

MHEC and the Maryland State Department of Education (MSDE) must also develop an electronic application (app) to better inform students about the availability of State financial aid and other helpful information for students preparing to attend college. No funding was provided for this purpose, but MHEC and MSDE report they will explore partnerships to develop the app.

State Financial Aid Waitlist and Changes to Programs

MHEC reports it has a waitlist in the EEA program of just over 22,000 students for Educational Assistance grants. To fully fund this need, MHEC would need an additional \$54.8 million, or an increase of nearly 100%, in fiscal 2017. MHEC reports it does have about \$8.0 million in canceled awards in fiscal 2017 that will be used to make additional awards in November 2016. With the academic year already underway, however, students must have enrolled in the fall semester prior to receiving the financial aid award in order to use the award, or they may enroll in the spring semester.

To make it easier for eligible students to receive State financial aid, OSFA is eliminating the application for the Guaranteed Access (GA) grant beginning with students enrolling in the 2017-2018 academic year. The GA grant awards students with the greatest financial need up to \$17,900 in fiscal 2017, the largest State-funded financial aid award. In lieu of applications, MHEC will identify potential GA recipients through the Free Application for Federal Student Aid (FAFSA) filings and contact students via mail. Notification letters will contain steps to accept the award and on how to submit the tax documentation that is required by June 1. Actual awarding is expected to begin in March, although this could happen sooner if institutions finalize their official cost of attendance earlier in the year. This change should also free up time for high school guidance counselors who can now shift from getting students to apply for GA grants to instead supporting FAFSA filing and verifying student information. The 2017-2018 application cycle is also different because the FAFSA became available on October 1 prior to the academic year, rather than January 1. This will give students an additional three months to fill out the FAFSA. At this time, no Maryland school has reported that it will move up financial aid awarding decisions due to the earlier FAFSA availability.

In regard to outreach and customer service given these changes, OSFA has committed to responding to all emails within 48 hours and has also launched a texting service. So far, about 10,000 students have signed up to receive text message alerts and tips about financial aid programs

and deadlines. This may have contributed to the award acceptance rate increasing from about 30% to 64% in the past year. MHEC is also working on reaching all rising high school seniors in the summer prior to senior year to create a required login for the FAFSA. Because this login is not connected to a specific year, students can create it at any time if they believe they may apply for aid in the future.

The Promise of Free Community College

Tennessee's Promise Scholarship has received nationwide attention as it effectively covers tuition and fees for any high school graduate who immediately enrolls in a community college. In total, four states have implemented new Promise or Promise pilot programs and, according to the National Conference of State Legislatures as of April 2016, similar legislation was introduced in 10 other states, including Maryland. Senate Bill 639 of 2016, which would have created a task force to study creating a program in Maryland, was instead sent to interim study. The four education subcommittees of the legislative budget and education policy committees met in November to examine the issue and college affordability more generally. Three counties in Maryland already offer Promise-like programs (Allegany, Garrett, and Wicomico) and a fourth county, Somerset, is considering it. The program in Allegany County is unique in that it provides a scholarship to residents to attend the community college or Frostburg State University, the public four-year institution located in the county. Additionally, Chapter 647 of 2016 created a task force to study establishing a program in Prince George's County.

One of the more difficult aspects of Promise is estimating how much it will cost the State, especially since federal programs have been proposed – but not yet implemented – to provide some federal cost sharing. Because community college tuition is relatively affordable, and the Tennessee program is a “last dollar” program, meaning existing financial aid grants are applied first before the Promise award is received, the average Tennessee Promise award was only \$1,020. The total cost to the state was \$10.6 million in fiscal 2016, but this is expected to scale up to about \$36.0 million when fully implemented. The Maryland Association of Community Colleges estimates a total annual cost to the State of \$60.0 million to \$70.0 million, or double Tennessee's projected full annual cost. This estimate assumes the same proportion of first-time, full-time students attend community college as currently do. However, it is likely that if a Promise scholarship were provided in Maryland, students who would otherwise attend a four-year institution or would not attend college at all would instead choose to enroll in community college. It is difficult to estimate how many students' enrollment behavior would change as a result of a Promise program. To date in Tennessee, community college enrollment has increased about 10%. Increases in community college enrollment would affect State funding in two ways, both increasing the total cost of Promise scholarships and increasing State aid through the community college funding formulas. MHEC and DLS are exploring Promise program costs using MHEC's Financial Aid Information System to use student-level data. Like tuition moderation policies, one potential downside to Promise scholarships is that the benefit primarily flows to students with an ability to pay for college as the federal Pell grant covers more than the cost of tuition and fees at Maryland community colleges for low-income students.

Maryland Student Loan Refinancing Authority Study

Many students finance higher education through loans from the federal government or private financial institutions, such as banks or credit unions. The amount of debt has increased significantly over time, including in Maryland. The most recent Maryland data reported for undergraduates at public and private, nonprofit four-year institutions by the Project on Student Debt, covering 2015 graduates, reports that 56% had student debt with an average debt (of those with loans) of \$27,672. This is nearly double the average amount reported by 2005 graduates.

No statewide entity or program for refinancing student loans currently exists in Maryland. The Maryland Higher Education Loan Corporation, a nonprofit corporation that provided loans to students for higher education expenses, was dissolved in 1996 and repealed from statute in 2005. However, several other states have established student loan financing and/or refinancing programs, including Connecticut, Rhode Island, and Minnesota.

Chapter 290 of 2016 requires MHEC and the Maryland Health and Higher Educational Facilities Authority (MHHEFA), in consultation with DLS and any other appropriate agencies, to study the expansion or creation of an appropriate bonding authority for the refinancing of student loans in Maryland. By September 30, 2017, MHEC and MHHEFA must report their findings and recommendations to the Governor and the General Assembly. The agencies have conferred over the direction of the study and are conducting independent research in their areas of expertise in preparation for additional discussions and the reporting deadline. Initial research topics include (1) the population served by a student loan refinancing program; (2) the role of the State in administration and/or oversight of a student loan refinancing program; and (3) a profile of other states' programs. As discussed in the fiscal and policy note for Chapter 290, the agencies believe that a consultant must be hired to accurately assess the demand for and potential costs of a refinancing program. While no funding was provided in the fiscal 2017 budget, the fiscal and policy note estimated the consultant services would cost \$50,000.

Higher Education

Funding Guidelines at University System of Maryland and Morgan State University

Chapter 25 of 2016 required the Governor to provide the University System of Maryland Office an additional \$4 million each year from fiscal 2018 to 2021 to increase the funding guideline attainment of those residential campuses that had the lowest attainment level in fiscal 2016. The goal is to raise the funding guideline attainment of those institutions as close as possible to 64% by fiscal 2021. In addition, a report from Morgan State University on a strategy to increase its attainment is due December 1, 2016.

Funding Guideline Attainment

The funding guidelines are a peer-based model used to inform the budget process by providing a funding standard and a basis for comparison. The guidelines were first used in fiscal 2001 to assess how Maryland's public four-year institutions were funded relative to their peers nationwide. An institution's funding peers are those that are similar in size, program mix, enrollment composition, and other defining characteristics. Beginning in 2015, the funding peers were revised to reflect institutions' peers in states that Maryland principally competes with for employers – California, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Virginia, and Washington.

The funding guideline for each institution is calculated by first summing the state appropriation and tuition and fee revenue per full-time equivalent student of the competitor state peer institutions. This per student amount is then multiplied by the projected enrollment of the institution. The projected tuition and fee revenue is then subtracted, resulting in the recommended State investment. Funding guideline attainment is expressed as a percentage, with the goal that Maryland public institutions receive funding at least equal to 75% of their peers (or 80% for the Historically Black Colleges and Universities).

University System of Maryland

Chapter 25 of 2016, while primarily formalizing the strategic partnership between the University of Maryland, College Park and the University of Maryland, Baltimore, also included a requirement that the University System of Maryland (USM) develop a strategy to enhance funding guideline attainment for those residential campuses farthest below the seventy-fifth percentile.

The bill required the Governor to provide at least an additional \$4 million for each fiscal year from 2018 to 2021 to the University System of Maryland Office (USMO) to specifically increase the attainment levels of those residential campuses with the lowest estimated funding guideline attainment level in fiscal 2016. As shown in **Exhibit 1**, under the fiscal 2016 estimated

funding guidelines, Towson University and the University of Maryland Baltimore County (UMBC) had the lowest funding guideline attainment of USM's residential institutions. USMO will determine how to allocate the additional \$4 million to the institutions with the goal of getting those institutions as close as possible to an estimated funding guideline attainment level of 64% by fiscal 2021. Funds allocated for the purpose of increasing attainment of the funding guideline will be incorporated into the institution's base budget, resulting in a total additional funding amount of \$16 million by fiscal 2021. USM will report on a multiyear strategy to enhance funding guideline attainment for institutions by December 1, 2016.

Chapter 25 also required USM to establish its corporate headquarters in Baltimore City by July 1, 2017, but allows it to maintain staff at other locations. USM will establish its headquarters at the Columbus Center, which is owned by UMBC. The Department of Legislative Services estimated the total cost of the move to be \$1.2 million in fiscal 2017, assuming 25 full-time positions will be relocated to Baltimore. USM must submit a relocation plan, including an estimate of all associated costs to the legislature by December 1, 2016.

Exhibit 1
Estimate of Funding Guideline Attainment for Fiscal 2016

<u>Institution</u>	<u>2016 Funding Guideline</u>	<u>2016 Legislative Appropriation</u>	<u>2016 Attainment</u>
Bowie State University	\$46,880,371	\$41,525,890	89%
Coppin State University	34,861,742	44,755,130	128%
Frostburg State University	45,444,946	38,470,741	85%
Salisbury University	66,992,685	47,533,057	71%
Towson University	177,855,983	107,050,342	60%
University of Baltimore	53,756,094	34,639,444	64%
University of Maryland (UM), Baltimore	317,827,128	215,405,339	68%
UM Baltimore County	189,588,395	111,151,119	59%
UM Center for Environmental Science	27,468,459	22,353,347	81%
UM, College Park	644,606,126	480,925,509	75%
UM Eastern Shore	49,051,468	38,083,911	78%
UM University College	72,352,702	38,596,667	53%
University System of Maryland Office		23,567,555	
University System of Maryland Total	\$1,726,686,099	\$1,244,058,051	72%
Morgan State University	\$113,744,575	\$84,564,601	74%
Total	\$1,840,430,674	\$1,328,622,652	72%

Source: Maryland Higher Education Commission

Morgan State University

Language in the 2016 *Joint Chairmen's Report* required Morgan State University (MSU) to submit a report on a multiyear strategy to enhance its funding guideline attainment. In September, MSU submitted a preliminary report stating that in order to be sufficiently funded, the funding guideline formula for MSU should be increased to the one hundred twenty-fifth percentile and identified over \$100 million in additional funding needs for the next five years. A final report is to be submitted by December 1, 2016.

Health and Health Insurance

The Future of the Federal Patient Protection and Affordable Care Act

In 2010, the federal Patient Protection and Affordable Care Act (ACA) was enacted to expand access to health insurance. Maryland has taken significant steps to implement the ACA. Since 2010, the percentage of uninsured Marylanders has fallen to 6.6%, with 281,000 individuals covered through the Medicaid expansion and more than 136,000 covered through the Maryland Health Benefit Exchange. Given the results of the U.S. election, substantial revision or repeal of the ACA is anticipated and could have tremendous fiscal and policy implications for Maryland.

The Federal Patient Protection and Affordable Care Act

In 2010, the federal Patient Protection and Affordable Care Act (ACA) was enacted. Major features of the law include (1) an individual mandate; (2) establishment of health benefit exchanges; (3) provision of federal premium and cost-sharing subsidies for individuals and families with incomes between 133% and 400% of federal poverty guidelines (FPG); (4) an employer mandate for employers with more than 50 full-time employees; (5) allowing states to expand Medicaid to individuals with incomes up to 138% FPG, primarily funded by the federal government; and (6) significant changes to private insurance including guaranteed issuance and renewal regardless of preexisting conditions, coverage for children up to age 26 on a parent's policy, limits on premium rate variations, a ban on lifetime limits, and a restriction on annual limits.

Since passage of the ACA, Maryland has brought State health insurance laws into compliance with federal consumer protections, standardized the premium rate review and approval process, established the Maryland Health Benefit Exchange (MHBE), expanded Medicaid, provided for the transfer of individuals formerly covered by the Maryland Health Insurance Plan (MHIP) (Maryland's former high-risk insurance pool) to other coverage, and repealed MHIP.

The Impact of Health Care Reform in Maryland

Since 2010, the percentage of uninsured Marylanders has declined from 11.3% to 6.6%. The largest gains in coverage have occurred through the expansion of Medicaid, with nearly 281,000 individuals enrolled under the expansion as of October 2016. More than 136,000 individuals have enrolled through MHBE. Most of these enrollees (75.0%) receive a federal advance premium tax credit (APTC) to help pay their monthly premiums, while 53.0% qualify for a cost-sharing reduction subsidy. Preliminary data indicates that access to health care has improved in Maryland with the expansion of coverage. Furthermore, hospital uncompensated care has declined, moderating growth in hospital rates. Additional information on the impact of

health care reform can be found in the Department of Legislative Services' report, *Assessing the Impact of Health Care Reform in Maryland*.

Substantial Revision or Repeal of the Affordable Care Act Anticipated

For many years, critics of the ACA have sought to repeal it and called for alternatives, contending that the ACA has proven costly and detrimental to the health insurance market and the economy. Common concerns are that the law has increased premiums and deductibles, resulted in narrow provider networks for plans offered on the exchanges, increased taxes to fund implementation, and imposed costs on employers to comply with the law. Substantial revision or repeal of the ACA is anticipated given the results of the presidential and congressional elections.

A number of congressional proposals to replace the ACA have been offered, most recently by House Speaker Paul D. Ryan in June 2016. The Ryan Proposal would eliminate the individual mandate, replace the current income-based APTCs with a new tax credit for individuals regardless of income, and expand the use of high-deductible “catastrophic” health plans paired with tax-free health savings accounts. President-elect Donald J. Trump has indicated support for these changes, but would like to preserve the ban on preexisting condition limitations and the provision that allows young adults to remain on their parents’ policies until age 26. A budget reconciliation bill including many of the changes supported by President-elect Trump passed the House and Senate in 2015, but was vetoed by President Barack H. Obama. While details are uncertain, repeal or substantial amendment of the ACA and/or the adoption of alternative reforms could have a tremendous impact on Maryland and will likely require the General Assembly to consider significant financial and policy decisions, which are outlined below.

Significant Financial and Policy Decisions for Maryland

- ***Medicaid Expansion:*** If the enhanced federal funding available for the Medicaid expansion is repealed, Maryland (along with 31 other states) must decide whether to maintain the expansion. If the State elects to preserve coverage, expenditures increase substantially. In fiscal 2018, the cost to serve the Medicaid expansion population is estimated to be \$2.85 billion, 94% of which is federally funded. In the absence of an enhanced federal matching rate, the net cost to Maryland (based on Maryland’s traditional 50% matching rate minus the State liabilities currently assumed under the ACA) would be \$1.27 billion in fiscal 2018, rising to \$1.33 billion in fiscal 2019, and \$1.50 billion by fiscal 2022.
- ***Loss of Enhanced Federal Matching Rate for Maryland Children’s Health Program:*** The ACA includes an enhanced matching rate for the Maryland Children’s Health Program through September 2019; in Maryland, this rate is 88%. Loss of this enhanced matching rate would increase general fund spending by an estimated \$68.0 million in fiscal 2018, \$72.8 million in fiscal 2019, and \$19.5 million in fiscal 2020.

- ***Maryland Health Benefit Exchange:*** The State will need to decide whether to continue MHBE and, if maintained, how to continue funding MHBE. In fiscal 2018, MHBE is estimated to be funded with a total of \$104.0 million (\$47.5 million in federal funds, \$56.3 million in special funds, and \$0.2 million in general funds). The special funds include \$35.0 million in premium tax revenues and \$21.3 million in former MHIP funds for the State Reinsurance Program (which is not planned to continue after fiscal 2018). State law mandates an annual appropriation of at least \$35.0 million to support MHBE.
- ***The All-payer Model Contract:*** Repeal of the ACA could have a profound impact on the Maryland all-payer model contract that governs hospital rate setting. The contract is between the State and the Center for Medicare and Medicaid Innovation (CMMI), which itself was established by the ACA. If the ACA (including CMMI) is repealed, Maryland could eventually lose the model contract, putting in jeopardy \$2.3 billion in Medicare and Medicaid payments to Maryland hospitals per year. If the model contract continues, the State could have difficulty meeting its obligation to limit annual growth in all-payer hospital per capita revenue and limit Medicare per beneficiary hospital cost growth. Under Maryland's all-payer system, the reasonable cost of hospital uncompensated care is recognized in the payment rates of all hospitals. The Health Services Cost Review Commission has taken action to meet the growth targets of the model contract, including approving a downward adjustment in hospital rates to reflect a reduction in uncompensated care, due to the ongoing impact of Medicaid expansion.

Additional Policy Issues for Consideration

- ***High Risk Pool:*** The ACA's prohibition on the denial of coverage for a preexisting health condition eliminated the need for MHIP. However, President-elect Trump may revive state-based high risk pools for individuals with preexisting conditions who allow their insurance to lapse. MHIP was funded with an assessment on hospitals that was added to hospital rates. In fiscal 2014 (the last full year of the program), MHIP expenditures totaled \$137.3 million. Restoring MHIP with the same funding source would add costs to hospitals.
- ***Mandated Benefits in Health Benefit Plans:*** The State would need to determine the coverage requirements for health benefit plans no longer subject to the ACA's minimum coverage requirements. For plans offered to individuals, there are a number of benefits mandated by State law that have continued to apply to plans grandfathered from the ACA requirements. The State could elect to extend the State coverage requirements to all plans offered to individuals. In addition, certain benefits are mandated under the ACA that are not mandated under State law, such as pediatric dental and vision coverage. The State would need to decide whether to require plans to continue to cover these ACA-mandated benefits.
- ***Changes to State Insurance Law:*** The State has adopted a number of changes to insurance law to conform with and implement the ACA. The changes include limits on premium rate

variation based on age and geography, which have been credited with helping older individuals afford insurance but faulted for keeping younger and healthier individuals out of the market. Repeal or significant revision may require the State to rollback and alter a number of these provisions to harmonize State requirements on carriers. State legislation also repealed a number of provisions of insurance law obsolete under the ACA that may need to be reestablished, such as standards governing medical underwriting by insurers.

Health and Health Insurance

Implementation of the All-payer Model Contract

In January 2014, Maryland replaced its historic Medicare waiver that governs hospital rate setting with the new Maryland all-payer model contract. Performance data for the first 30 months indicates that implementation is generally proceeding well, and Maryland is on pace to meet or exceed the requirements.

Background

Effective January 1, 2014, Maryland entered into a contract with the federal government to replace the State's 36-year-old Medicare waiver with the new Maryland all-payer model contract. Under the waiver, Maryland's success was based solely on the cumulative rate of growth in Medicare inpatient per admission costs. Under the model contract, however, the State not only will limit inpatient, outpatient, and Medicare per beneficiary hospital growth but also shift hospital revenues to a population-based system and reduce both hospital readmissions and potentially preventable complications. The model contract will be deemed successful if Maryland can meet cost and quality targets without inappropriately shifting costs to nonhospital settings and if there is a measurable improvement in quality of care.

Implementation of the All-payer Model Contract

The Health Services Cost Review Commission (HSCRC) has taken action to implement the model contract and ensure that its requirements are met. Major actions over the last 12 months include:

- **Stakeholder Engagement:** HSCRC has convened multiple groups to advise the commission on various aspects of the model contract, and, pursuant to recommendations by consumer workgroups, established a Standing Consumer Advisory Committee.
- **Alternative Methods of Rate Determination:** All hospitals were transitioned to Global Budget Revenue (GBR) and Total Patient Revenue agreements by the end of 2015. HSCRC has begun to work with stakeholders on how to augment the existing budget concepts with a new, population-based arrangement in the future.
- **Uncompensated Care:** The uncompensated care provision in hospital rates was reduced from 5.25% for fiscal 2016 to 4.69% for fiscal 2017. The reduction reflects the ongoing impact of Maryland's January 2014 Medicaid expansion on levels of uncompensated care.

- **Annual Update Factor:** HSCRC approved a fiscal 2017 update factor of 2.72% for GBR hospitals, limiting the amount provided in the first six months to an increase of 2.16% by having a lower semiannual target for the first half of the year and a higher semiannual target for the second half of the year. HSCRC also approved an update factor of 1.24% for other regulated hospital revenues.

Performance on Requirements of the Model Contract

In October 2016, HSCRC released an update on Maryland's performance implementing the all-payer model contract. Generally, implementation appears to be progressing well, and Maryland is on pace to meet or exceed the requirements of the model contract. **Exhibit 1** displays the requirements the State must meet and the status of the State's performance.

One potential area of concern is an increase in the Medicare total cost of care in calendar 2015. The all-payer model contract provides that, in any one calendar year, Medicare total cost of care growth in Maryland may not grow more than 1.0% above Medicare total cost of care growth nationally. Additionally, in any two consecutive years, Maryland's Medicare total cost of care growth may not exceed national growth. In calendar 2015, Maryland's total cost of care grew by 0.7% more than national growth. HSCRC advises that it is closely monitoring Medicare total cost of care and is prepared to take action to ensure that the two consecutive year requirement is not breached.

Next Steps for the Model Contract

Building on the success of the first phase of the model contract, HSCRC is developing and implementing changes which will shift the focus from the cost of hospital care to the total cost of care in the State. A plan for phase two of the contract is due to the federal Center for Medicare and Medicaid Services (CMS) by the end of 2016. The key themes of the draft plan circulating in early November are to (1) foster accountability for systemwide and patient-level goals; (2) align measures and incentives for all providers; (3) encourage and develop payment and delivery system transformation approaches; and (4) ensure availability of tools to support providers in achieving transformation goals.

Revisions to the model will include integrated care incentives, such as integrated care networks, pay-for-performance programs, and gain sharing programs to achieve the goals of care coordination and provider alignment. The State has received approval for an amendment to implement specific care redesign strategies, which will allow hospitals to access comprehensive Medicare data, share resources, and offer incentives to non-hospital care partners. As part of the care redesign strategies, the State is developing initiatives for an Accountable Care Organization serving individuals eligible for both Medicare and Medicaid and for a Maryland CPC+ Primary Care Home for Medicare beneficiaries. The CPC+ Primary Care Home aims to improve health care outcomes by managing care across all providers delivering care to a patient. It will

also allow participating providers to qualify for Medicare bonus payments. (See separate issue paper on Medicaid Dual-eligible Service Delivery Efforts for a fuller discussion of the Accountable Care Organization initiative.) Changes will also emphasize the utilization of the Chesapeake Regional Information System for our Patients, the State designated health information exchange, and other health information technology tools.

Exhibit 1
Maryland’s Performance on the Requirements of the
All-payer Model Contract as of October 2016

<u>Requirement</u>	<u>Initial Performance/Status</u>
Total Hospital Cost Growth: Limit annual growth in all-payer hospital per capita revenue for Maryland residents to 3.58% growth.	Per capita revenue for Maryland residents grew by 1.47% from calendar 2013 to 2014, and by 2.31% from calendar 2014 to 2015. Calendar 2016 growth through June was up 1.47% over the same period in calendar 2015.
Medicare Total Hospital Cost Growth: Limit Medicare per beneficiary hospital cost growth to produce \$330 million in cumulative Medicare savings over five years.	According to available data, Maryland realized \$116 million in savings in calendar 2014 and \$135 million in calendar 2015. Calendar 2016 data are considered preliminary and have not yet been approved for public release by the Centers for Medicare and Medicaid Services.
Population-based Revenue: Shift hospital reimbursement from a per case to a population-based system, with at least 80.0% of hospital revenues shifted to global budgeting over five years.	All hospitals are under Global Budget Revenue or Total Patient Revenue agreements. Ninety-six percent of hospital revenue has been shifted to global budgets; the remaining 4.0% is excluded out-of-state revenue for five hospitals.
Reduction of Hospital Readmissions: Reduce the Medicare readmission rate to below the national average over five years.	Between calendar 2013 and 2015, the gap between the Maryland and the national all-cause readmission rate among Medicare patients decreased by 0.69%, from 1.2% to 0.51%.
Reduction of Hospital-acquired Conditions: Achieve a cumulative reduction of potentially preventable complications of 30.0% over five years.	In June 2016, the all-payer risk-adjusted potentially preventable complications (PPC) rate was 0.64 per 1,000 compared with 1.29 per 1,000 in June 2013, a 47.3% reduction. The Health Services Cost Review Commission will continue to set annual improvement targets for hospitals to further reduce PPC.

Source: Health Services Cost Review Commission; Department of Legislative Services

Health and Health Insurance

Medical Cannabis Commission

Under Maryland's medical cannabis law, a qualifying patient who has a written certification from a certifying provider, including a physician, dentist, podiatrist, nurse practitioner, or nurse midwife, may obtain medical cannabis. The Natalie M. LaPrade Medical Cannabis Commission published final regulations governing the program and began the approval process for growers and processors in 2015. However, the approval process has faced significant controversy regarding geographic, racial, and ethnic diversity. Compared with other states, Maryland's implementation of medical cannabis has been slow.

Natalie M. LaPrade Medical Cannabis Commission

The Natalie M. LaPrade Medical Cannabis Commission is responsible for the implementation of programs to make medical cannabis available to qualifying patients in a safe and effective manner. The commission oversees licensing, registration, inspection, and testing related to the State's medical cannabis program and provides relevant program information to patients, physicians, growers, dispensers, processors, testing laboratories, and caregivers.

Chapter 251 of 2015 authorized a qualifying patient who has been provided with a written certification from a certifying physician in accordance with a *bona fide* physician-patient relationship to obtain medical cannabis. Chapter 474 of 2016 expanded the types of health care practitioners who may discuss medical cannabis with a patient, complete an assessment of a patient's medical condition, and certify that a patient qualifies for medical cannabis to include dentists, podiatrists, nurse practitioners, and nurse midwives.

Statute dictates that cannabis may only be obtained from a grower or dispensary licensed by the commission, and that the commission may license no more than 15 growers. There is no established limit on the number of processor licenses. While there is no specific restriction on the number of dispensaries in statute, regulations set a limit of 2 dispensary licenses per senatorial district, or up to 94 dispensary licenses statewide. Most states with medical cannabis programs cap the number of growers, processors, and dispensaries in order to manage production and limit the size of the industry. States also typically use a merit-based application process to identify the best applicants and award licenses to those deemed most qualified. The commission is in the process of awarding grower, processor, and dispensary licenses.

Grower and Processor License Application Process

The commission opened applications for grower, processor, and dispensary licenses in September 2015. The application forms included instructions and a description of the scoring process for evaluating the applications. The commission received 145 grower applications, 124 processor applications, and 811 dispensary license applications. Towson University's Regional Economic Studies Institute (RESI) was commissioned to review the grower and processor applications through a double-blind review process in which all identifying information was redacted. The scoring system contained six main categories, including additional factors, which stated that, for scoring purposes, the commission may take into account the geographic location of the growing operation to ensure there is geographic diversity in the award of licenses. In August 2016, the commission announced the 15 growers and 15 processors who were awarded stage one license preapprovals. The evaluation procedures to be used in the award of dispensary licenses were adopted by the commission in November 2016.

Controversy Over Geographic, Racial, and Ethnic Diversity

Since the award announcement, there has been significant controversy surrounding two main issues: (1) the decision to include geographic diversity as a final factor in choosing the grower finalists and (2) the fact that none of the 15 stage one approved grower finalists are led by minorities.

Geographic diversity became an issue when two companies among the top 15 ranked growers did not receive preapproval after being replaced by other companies in order to provide geographic representation throughout the State. Although the applications did not require applicants to include information related to location, in June 2015, the commission subsequently asked applicants for the locations of their prospective operations. In July 2015, a subcommittee of the commission unanimously voted to preliminarily approve the top 15 growers based on RESI's scoring, which did not include a consideration of location. Afterward, three members of the subcommittee reversed their vote, which resulted in two lower-ranked firms being moved into the top 15 growers in order to achieve geographic diversity. The two companies that were initially included in the top 15 growers but later removed are suing the commission, claiming that the determination of how geographic diversity was to be considered was unclear to applicants.

In September 2016, the Legislative Black Caucus held an all-day meeting at which the caucus stated its intent to ensure that the grower licensure process does not move forward without representation from companies owned by African Americans. In October 2016, a company that is majority owned by African Americans and was denied a grower license filed a lawsuit against the commission seeking to halt the medical cannabis program until the commission takes action to ensure racial and ethnic diversity among licensed growers.

Commission’s Response

Despite the controversy, the commission maintains it had the authority to take geographic diversity into account, and that it declined to make preapproval awards based on racial diversity due to advice received from the Office of the Attorney General (OAG). According to the commission, racial diversity was initially included as a weighted component in the application process, since § 13-3306 of the Health-General Article requires the commission to “actively seek to achieve racial, ethnic, and geographic diversity when licensing medical cannabis growers” and to “encourage applicants who qualify as a minority business enterprise.” The commission contends that it was necessary to remove racial and ethnic considerations from final application regulations based on a letter from an assistant Attorney General (AAG) advising that constitutional limits prevent the commission from considering race or ethnicity when licensing when there is no disparity study that indicates past discrimination in similar programs. The AAG letter also states that there is no constitutional limitation on considering geographic diversity and that the provisions of § 13-3306 of the Health-General Article require the commission to seek to achieve geographic diversity to the extent possible. After the award of the licenses, OAG stated that the commission could have commissioned a racial disparity study in similar industries to justify allowing racial preferences.

Status of Medical Cannabis Implementation

The chair of the commission has stated that the commission is committed to seeking and promoting racial diversity and minority inclusion and will continue to work with the legislature to help solve these complex problems but does not want to further delay the program. If the program continues without delay, the commission expects to issue final licenses by early 2017.

Nationally, the majority of states have some form of medical cannabis authorization. Twenty eight states have comprehensive medical cannabis laws similar to Maryland’s, and 17 states have limited access laws that allow the use of “low THC, high cannabidiol (CBD)” products for medical reasons in limited situations or as a legal defense. Compared to other states, Maryland has been slow to implement its medical cannabis program.

Recreational Use of Cannabis Gains Momentum in Other States

Although not legal in Maryland, authorization of the recreational use of cannabis has gained momentum across the country. Prior to the November 2016 election, recreational use was legal in four states (Alaska, Colorado, Oregon, and Washington) and the District of Columbia. In the November 2016 election, ballot initiatives to legalize recreational use passed in California, Massachusetts, Maine, and Nevada.

Health and Health Insurance

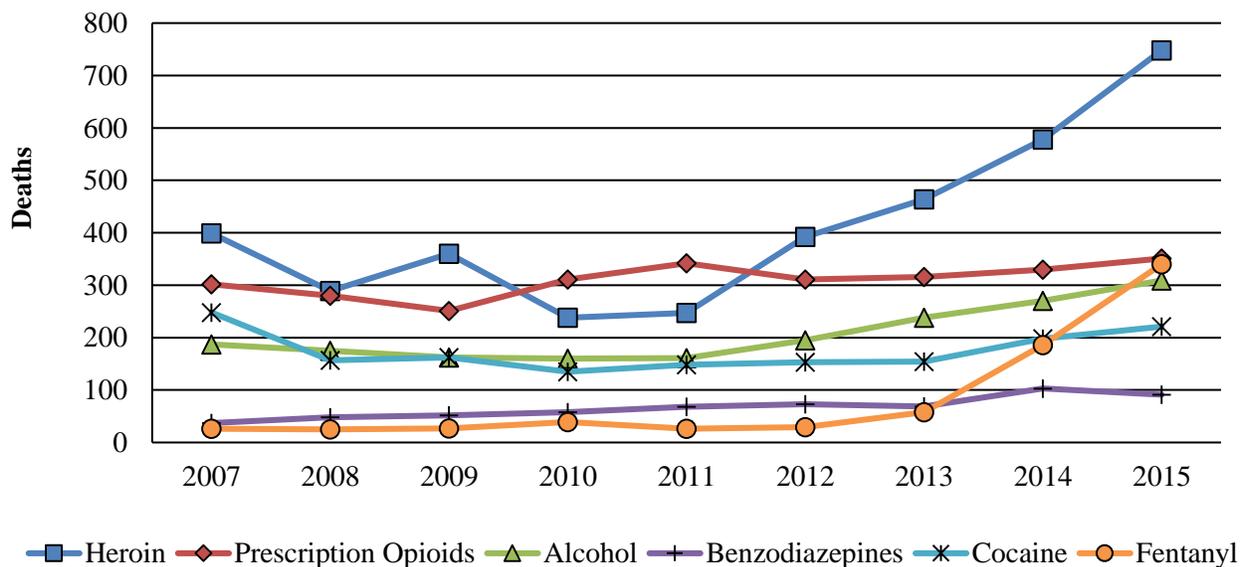
Opioid Overdose Issues

The rate of opioid-related overdose deaths in Maryland, particularly heroin and fentanyl-related deaths, continues to rise at an alarming rate. To combat this public health threat, the State has, among other actions, established an Inter-Agency Heroin and Opioid Coordinating Council, the Heroin and Opioid Emergency Task Force, and the Joint Committee on Behavioral Health and Opioid Use Disorders. The Department of Health and Mental Hygiene has also implemented an overdose prevention strategy.

Opioids Comprise Majority of Overdose Deaths in Maryland

In Maryland, the rate of opioid-related overdose deaths continues to rise at an alarming rate. As seen in **Exhibit 1**, between 2014 and 2015, the number of heroin-related deaths increased 29% (from 578 to 748), the number of fentanyl-related deaths increased 83% (from 186 to 340), and the number of prescription-opioid related deaths increased by 6% (from 330 to 351).

Exhibit 1
Total Number of Drug- and Alcohol-related Intoxication Deaths
By Selected Substances in Maryland
2007-2015



Source: Department of Health and Mental Hygiene

The number of fentanyl-related deaths began increasing in late 2013 as a result of overdoses involving nonpharmaceutical fentanyl, which is produced in laboratories and mixed with heroin or other illicit substances.

Federal Comprehensive Addiction and Recovery Act of 2016

In July 2016, President Barack H. Obama signed the Comprehensive Addiction and Recovery Act (CARA), which authorizes over \$181 million each year in new funding and is the first major federal substance use legislation in 40 years. Specifically, the CARA:

- expands office-based treatment by allowing nurse practitioners and physician assistants to prescribe buprenorphine for opioid addiction;
- requires that office-based treatment practitioners have the capacity (including necessary training) to either provide directly, or by referral, all drugs approved by the Food and Drug Administration for the treatment of opioid use disorder;
- authorizes grants to opioid treatment programs and practitioners who offer office-based medication assisted treatment to expand access to naloxone through co-prescribing;
- reauthorizes funding for the National All Schedules Prescription Electronic Reporting Act for states to improve or maintain a prescription drug monitoring program;
- directs the U.S. Secretary of Health and Human Services to develop recommendations regarding education programs for opioid prescribers;
- authorizes grants to states to expand evidence-based medication assisted treatment in areas with high rates of opioid and heroin use;
- authorizes grants to state substance abuse agencies to carry out pilot programs for nonresidential treatment of pregnant and postpartum women; and
- authorizes grants to states to implement integrated opioid abuse response initiatives, including expanding availability of medication assisted treatment and behavioral therapy for opioid addiction.

Inter-Agency Heroin and Opioid Coordinating Council

In February 2015, the Governor issued two executive orders establishing the Governor's Inter-Agency Heroin and Opioid Coordinating Council and the Heroin and Opioid Emergency

Task Force to establish a coordinated statewide and multijurisdictional effort to prevent, treat, and significantly reduce heroin and opioid abuse.

In December 2015, the task force submitted a final report that contained 33 final recommendations, 10 interim recommendations, and 10 resource allocations. Of the final 33 recommendations, 8 relate to expanding access to treatment; 5 relate to enhancing quality of care; 2 relate to boosting overdose prevention efforts; 6 relate to escalating law enforcement options; 6 relate to reentry and alternatives to incarceration; 4 relate to promoting education tools for youth, parents, and school officials; and 2 relate to improving State support services. In August 2016, the council submitted a mid-year report to the Governor that focused on the recommendations contained in the task force's final and interim reports. As for expanding access to treatment, among other initiatives, the Behavioral Health Administration (BHA) has implemented a statewide buprenorphine access expansion plan and the Governor's Office of Crime Control and Prevention funded 11 reentry medication assisted treatment Vivitrol programs.

Joint Committee on Behavioral Health and Opioid Use Disorders

Chapter 464 of 2015 established the Joint Committee on Behavioral Health and Opioid Use Disorders, comprised of five senators and five delegates, to oversee the State's Prescription Drug Monitoring Program (PDMP) and State and local programs to treat and reduce opioid use. The joint committee is required to monitor the activities of the Governor's Inter-Agency Heroin and Opioid Coordinating Council and the effectiveness of the State Overdose Prevention Plan; local overdose prevention plans and fatality review teams; strategic planning practices to reduce prescription drug abuse; and efforts to enhance overdose response laws, regulations, and training.

During the 2016 interim, the joint committee received briefings from the Department of Public Safety and Correctional Services and the Department of Health and Mental Hygiene (DHMH) on the removal of suboxone film from the Medicaid pharmacy preferred drug list. The action was controversial among providers who argued that such removal disrupts the clinical care of patients. A reason stated for the removal was smuggling of the product into prisons. The joint committee also received briefings from the Governor's Inter-Agency Heroin and Opioid Coordinating Council on DHMH's Opioid Treatment Workgroup work plan, and on the feasibility and desirability of analyzing prescription drug monitoring data.

Department of Health and Mental Hygiene Overdose Prevention Strategy

DHMH established an overdose prevention strategy with the goals of improving epidemiology and strategic planning, providing naloxone training and distribution, reducing prescription opioid misuse and inappropriate prescribing, and targeting outreach to high-risk individuals for treatment and recovery support services through programs such as:

- **Overdose Response Program** – In December 2015, a statewide standing order was issued that allows all Maryland pharmacists to dispense naloxone without a prescription to anyone trained and certified under the Overdose Response Program. The program has authorized 58 organizations to conduct naloxone trainings and issue certificates, including local health departments, substance related disorder programs, community organizations, and law enforcement agencies. Since March 2014, over 34,000 individuals have been trained, over 38,000 doses of naloxone were dispensed, and 1,181 administrations were reported.
- **Prescription Drug Monitoring Program** – Chapter 147 of 2016 requires all Maryland-licensed prescribers and pharmacists to register with PDMP by July 1, 2017. PDMP helps providers identify patients who may be misusing opioids and other prescription drugs by providing real-time, online access to their patients’ controlled substance prescription history. Beginning in 2018, providers will be required to use PDMP before prescribing opioids or benzodiazepines, a group of sedative medications that present significant overdose risks particularly when prescribed and used in combination with opioids.
- **Local Overdose Fatality Review Teams** – Local overdose fatality review teams are multiagency/multidisciplinary teams assembled at the jurisdictional level to conduct confidential reviews of overdose deaths. The goals of the teams are to prevent future deaths by identifying missed opportunities for prevention; build working relationships with local stakeholders; and recommend policies, programs, and laws to prevent overdose. DHMH provides data and technical assistance to the 18 teams. Teams have found that decedents have had significant contact with government systems, alcohol is often involved, older drug users are at high risk due to co-occurring chronic health issues, care coordination needs improvement, and there is often an occurrence of trauma just before death.
- **Opioid Misuse Prevention Programs in Local Jurisdictions** – Funds are provided to 22 jurisdictions to strengthen and enhance their local overdose prevention plans through data, analysis, strategic planning, and implementation of evidence-based opioid misuse prevention strategies.
- **Overdose Survivors Outreach Program** – The Overdose Survivors Outreach Program is an initiative to improve health outcomes for overdose survivors or those at risk for overdose by collaborating with hospitals and local health departments to facilitate interventions by peer recovery specialists in the emergency department. As of August 2016, four hospitals in Baltimore City and two hospitals in Anne Arundel County are participating in the program; 130 individuals have been referred to treatment through peers and 40% of survivors have been engaged in treatment.
- **Screening, Brief Intervention and Referral to Treatment** – DHMH is expanding access to Screening, Brief Intervention and Referral to Treatment (SBIRT), an evidence-based tool used to identify individuals with the potential for substance abuse and provide medical

and behavioral intervention. Funded through a five-year federal grant, SBIRT will be implemented in 53 community primary care centers and two hospital emergency departments in 15 jurisdictions with the expectation of screening at least 90,000 primary care patients to identify and intervene with at-risk behaviors. Additional private funding has positioned the State to expand SBIRT to adolescent primary care patients in selected clinics and several college and university health care settings.

- **Fentanyl Awareness** – DHMH has filmed a public service announcement in partnership with Maryland Public Television that is being broadcast on stations throughout the State. Pocket size cards describing the dangers of fentanyl and recognizing the signs of an overdose will be sent to all local health departments.
- **Family Support Navigation System** – In partnership with the Maryland Coalition of Families, BHA is implementing a Family Support Navigation System to empower and inform families caring for youth, adolescents, and young adults facing challenges related to substance use. The goal is to connect families to peers who have experience coping with substance-related behaviors and are trained to connect families to recovery support services in their communities that promote improving quality of life, preventing relapse, and sustaining recovery.

Health and Health Insurance

Forensic Services

In 2016, patients who were required by Maryland law to be evaluated by or committed to Department of Health and Mental Hygiene facilities were not receiving the required services due to lack of available bed space. As a result, contempt hearings were held ordering the Secretary of Health and Mental Hygiene to explain why individuals were remaining in jail in violation of the law. In July 2016, the Secretary established a Forensic Services Workgroup to address specific issues with the forensic system of care, including the lack of available State hospital beds to complete court-ordered forensic evaluations and to honor court commitments within statutory time requirements. In August 2016, the workgroup issued several recommendations and took action to significantly reduce the backlog of individuals waiting for evaluation and treatment in State facilities.

Forensic Services

The Behavioral Health Administration (BHA) operates an Office of Forensic Services (OFS) within the Department of Health and Mental Hygiene (DHMH). The office interacts with criminal courts in the State to respond to certain forensic issues set forth in various sections of Title 3 of the Criminal Procedure Article and Title 8 of the Health-General Article.

Subject to §§ 3-105 and 3-111 of the Criminal Procedure Article, OFS is responsible for evaluating defendants' competency to stand trial and their criminal responsibility for the crimes with which they are charged. OFS contracts with forensic evaluators in every jurisdiction to conduct these evaluations. While a majority of the cases require no further evaluation, some cases require further assessment, in which the defendant is referred to a State facility, or result in a commitment to a State facility for treatment pursuant to §§ 3-106(b) or 3-112 of the Criminal Procedure Article. In addition, §§ 8-505, 8-506, and 8-507 of the Health-General Article require DHMH to conduct certain court-ordered evaluations to determine whether a defendant is in need of and may benefit from certain substance use treatments and authorize a court to commit a defendant to DHMH for inpatient evaluation or treatment for substance use under certain circumstances.

In 2016, it became clear that DHMH lacked the adequate bed space or other additional capacity to receive people committed to DHMH under the Criminal Procedure Article. Numerous contempt hearings were held in Baltimore City and Prince George's County where officials from DHMH and OFS, including the Secretary of Health and Mental Hygiene, were asked why State hospitals were too full to accept any new patients and why the hospitals were turning away patients and forcing them to remain incarcerated in violation of the law. In a letter to the Judiciary in April 2016, the Secretary of Health and Mental Hygiene identified the bed shortage and inability

of DHMH to admit patients in a timely manner as a crisis for DHMH and committed to resolve the issue as quickly as possible.

Forensic Services Workgroup

In order to begin resolving the issue, and to address stakeholder concerns regarding significant delays associated with court-involved individuals navigating the State's forensic system of care, the Secretary of Health and Mental Hygiene convened a Forensic Services Workgroup. The workgroup, composed of community stakeholders (including representatives from the Judiciary, prosecutors, public defenders, community providers, consumers, and advocates for individuals with mental illness), was asked to address various longstanding issues with the forensic system of care, including (1) the lack of availability of State hospital beds to complete court-ordered forensic evaluations as well as to honor court commitments within statutory time requirements; (2) the length of time it takes for individuals assessed as ready for release following their commitment by the courts to return to court for disposition; (3) appropriate placement of incarcerated individuals ordered for evaluation and assessed, but not yet adjudicated as incompetent; and (4) the impact on State facility staff from State hospitals' census consistently being at or above maximum capacity, managing a predominately forensic patient population, and not being staffed or compensated based on a "forensic" classification.

The workgroup met on four occasions and issued a final report on August 31, 2016, which contained numerous recommendations, including:

- increasing bed capacity within DHMH, including the immediate opening of 24 inpatient hospital beds to address the current backlog of court-committed individuals, the rapid creation of 24 "step-down" beds within the existing DHMH infrastructure, expedited contracting with community-based hospitals to use private-sector psychiatric beds, and an expedited re-assessment of actual bed needs;
- increasing availability of community crisis services, including an immediate statewide assessment of currently available crisis services, a rapid determination of which active crisis services programs are most effective in responding to crises in a way that minimizes entry and re-entry into the criminal justice system, and expedited funding support through budget reallocation as well as additional budget allocations to the most effective programs;
- expanding the capacity of OFS, including an immediate increase in the number and efficiency of forensic services staff, a rapid restructuring of DHMH chain of command to fully integrate the management, delivery of services, and reporting of findings to the court under OFS, and an expedited review of newly generated data to determine where to place existing resources and evaluate the need for additional resources;
- increasing outpatient provider capacity to meet the needs of forensic patients, including an immediate increase in support to existing providers who already accept forensically involved patients, the rapid assessment of outpatient provider reimbursement structure, and

the expedited increase of rates of reimbursement and the types of services that are reimbursable;

- centralizing DHMH’s forensic processes, including the immediate centralization of all processes related to the delivery of forensic services, the rapid reassessment and reclassification of staff at all State hospitals to a forensic classification, and the expedited implementation of salary and staffing changes; and
- increasing education to reduce stigma in both the general public and the mental health treatment community, including the immediate inclusion of anti-stigma education for providers who receive training to treat forensically involved patients, the rapid development and expansion of public anti-stigma educational programs, including the use of crisis intervention training for police and first responders, and the expedited inclusion of anti-stigma educational funding in the next budget cycle.

DHMH, BHA, and OFS have taken numerous steps to address some of the recommendations, which were presented to several legislative committees at a hearing on September 13, 2016. Specifically, DHMH will contract with Bon Secours Hospital to operate a pretrial diversion program, which will divert patients to the Bon Secours Hospital prior to their entry into the formal forensic system of care. The State has also partnered with a community provider at Springfield Hospital Center to run a program, known as Segue, which will provide 16 transitional beds onsite at the Springfield Hospital Center. Finally, the Secretary of Health and Mental Hygiene has begun the process of appointing a new advisory council, which will track DHMH’s progress on the recommendations on an ongoing basis. This new council will begin meeting before the end of 2016.

During the workgroup process, DHMH identified numerous patients who were still residing within State hospitals but who no longer met the medical criteria for inpatient care. After identifying these patients, BHA and OFS were able to secure sufficient wraparound services and other treatment options to enable the release of these patients from the hospital. This has allowed the State hospitals to not only reduce census numbers to below 100%, but as of the September 13 legislative hearing to reduce the number of individuals waiting in jails throughout the State for a State hospital placement from 84 to 12. Further updates on the number of individuals awaiting placement as well as the overall census numbers of the State facilities will be presented during the 2017 legislative session.

Health and Health Insurance

Medicaid Enrollment and Expenditure Trends

Rate increases to managed care organizations and a higher than anticipated growth in Medicaid enrollment are driving an anticipated fiscal 2017 general fund deficit of \$124.1 million. Fiscal 2018 expenditures are estimated to be just over \$11.4 billion, an almost \$1.5 billion (14.7%) increase over the fiscal 2017 legislative appropriation but only \$466.0 million (4.3%) over projected fiscal 2017 expenditures.

Overview

Maryland's Medical Assistance Programs (Medicaid, Maryland Children's Health Program (MCHP), Employed Individuals with Disabilities, *etc.*) provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate in fiscal 2018 of 50.0% to 94.5% for Medicaid, depending on the eligibility category, and 88.0% for the MCHP.

Fiscal 2017 Projected Deficit

There is a projected general fund deficit of \$124.1 million in the Medicaid program in fiscal 2017. Of this amount, \$93.4 million is on the somatic side of the program and is driven by both a calendar 2016 mid-year adjustment to managed care organization (MCO) rates (an increase of 3.7%), plus a calendar 2017 1.1% rate increase. Although the calendar 2017 rate increase overall is small, rates for the population groups for which the State has a greater financial responsibility increase by an estimated 4.7%. Conversely, rates for the new Affordable Care Act (ACA) expansion group, largely federally funded, fall by an estimated 4.9%.

The other major contributor to the deficit is a higher than anticipated growth in enrollment. However, the general fund budgetary impact of this enrollment growth is mitigated as more of the projected growth is in eligibility categories for which the State gets a large federal match. Additionally, a greater proportion of the overall enrollment is being served in MCOs rather than through fee-for-service (FFS), which tends to lower overall costs. Other factors that are softening the general fund impact of MCO rate increases and enrollment growth include lower than anticipated inpatient and outpatient rate increases and higher than budgeted pharmacy rebates.

For Medicaid-funded behavioral health programs, a deficit of \$30.7 million is anticipated in fiscal 2017, \$10.7 million from fiscal 2016, and \$20.0 million from fiscal 2017. These deficits are largely attributed to higher than anticipated expenditures on substance use disorder (SUD) treatment. It is worth noting that fiscal 2016 was the first full year of the carve-out of SUD services for Medicaid recipients from MCOs to a FFS system.

Fiscal 2018 Medicaid Outlook

In fiscal 2018, expenditures for the Medical Assistance Programs are estimated to be just over \$11.4 billion, an almost \$1.5 billion (14.7%) increase over the fiscal 2017 legislative appropriation. As shown in **Exhibit 1**, most of this increase, almost \$1.1 billion, is in federal funds, with general fund growth of \$388.7 million (13.3%). However, growth over projected fiscal 2017 expenditures is a more modest \$466.0 million (4.3%). Of this amount, \$275.2 million is general funds. Special fund attainment is virtually unchanged.

Exhibit 1
Medicaid Expenditures
Fiscal 2016-2018
(\$ in Millions)

	<u>2016</u> <u>Actual</u>	<u>2017 Legislative</u> <u>Appropriation</u>	<u>2017</u> <u>Projected</u>	<u>2018</u> <u>Baseline</u>
General Funds	\$2,602.0	\$2,926.5	\$3,040.0	\$3,315.2
Special Funds	1,001.9	946.8	948.3	950.5
Federal Funds	6,059.9	6,029.4	6,912.5	7,101.2
Reimbursable Funds	68.9	57.7	57.7	57.7
Total	\$9,732.8	\$9,960.3	\$10,958.5	\$11,424.4

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

Source: Department of Legislative Services

The key driver of growth in the fiscal 2018 baseline is MCO rate increases. The impact of the rate increases that are primarily responsible for the projected fiscal 2017 deficit carries over into fiscal 2018. Further, the fiscal 2018 baseline assumes a 3.1% MCO rate increase to recognize the resumption of the ACA insurer fee that is scheduled to be reinstated in calendar 2018 after a one-year moratorium in calendar 2017. Other significant costs assumed in the fiscal 2018 baseline include the first full fiscal year of the State's growing assumption of a share of the costs associated with the new ACA expansion eligibility population, modest rate increases for FFS providers, continuing demand for SUD services, and accommodating enrollment growth of 2.3% (see **Exhibit 2**).

Exhibit 2
Enrollment and Service Year Per Capita Expenditures*
Fiscal 2016-2018

	<u>2016</u> <u>Actual</u>	<u>2017</u> <u>Estimate</u>	<u>2018</u> <u>Baseline</u>	<u>2017-2018</u> <u>% Change</u>
Enrollment by Category				
Medicaid	853,863	899,028	916,410	1.9%
MCHP	134,931	148,424	152,877	3.0%
ACA Medicaid Expansion	233,128	282,084	290,547	3.0%
Total	1,221,921	1,329,536	1,359,833	2.3%
Cost Per Enrollee				
Medicaid	\$8,808	\$9,092	\$9,360	3.0%
MCHP	2,074	2,246	2,304	2.6%
ACA Medicaid Expansion	9,487	9,871	9,797	-0.7%

ACA: Affordable Care Act

MCHP: Maryland Children's Health Program

*Expenditures by fiscal year are based on the cost of providing services during that fiscal year rather than the year that the bills were paid. Cost estimates are based on provider reimbursements and expenditures in programs MQ0103, MQ01016, MQ0107, and MQ0110 only.

Source: Department of Legislative Services

Health and Health Insurance

Medicaid Dual-eligible Service Delivery Reform

Medicaid expenditures for Maryland's dually eligible population are particularly high. In early 2016, the Maryland Duals Care Delivery Workgroup was established to examine how the State can best manage the dually eligible population. After consideration of several service delivery models, the workgroup has opted to investigate a hybrid system utilizing mandatory accountable care organization enrollment in certain jurisdictions and managed fee-for-service in the rest of the State. Although no final decisions have been made and several issues need to be resolved regarding a proposed service model, a concept plan will be submitted to the federal government at the end of 2016.

Background

Dual-eligible beneficiaries qualify for both Medicare and Medicaid services. Most dual eligibles (64% in calendar 2012) qualify for the full range of Medicaid benefits, which often include services that are not covered by Medicare (for example, long-term care), while the remainder do not qualify for the full range of Medicaid benefits but receive assistance with Medicare premiums and cost sharing. There are numerous eligibility paths to becoming a dual-eligible beneficiary. The most common, applying to 70% of beneficiaries, is being enrolled in Medicare and “spending down” (incurring significant medical expenses) to reduce income and assets to become eligible for Medicaid. About 27% of dual eligibles are enrolled in Medicaid as a result of a disability and qualify for Medicare after a waiting period. Generally, about 55% of the dual eligibles are age 65 or older, while 45% are younger than age 65.

The number of dual eligibles is relatively small compared to the total Medicaid population. In calendar 2012, there were 88,150 full-benefit dual eligibles and 50,633 dual eligibles receiving partial benefits representing 11.8% and 6.8% of total Medicaid beneficiaries age 16 and older, respectively. However, the extent of Medicaid spending on the dually eligible is particularly high: over \$1.6 billion in calendar 2012, or \$21,550 per person on dual-eligible individuals with full Medicaid coverage. This compares to an estimated \$7,083 per person for the Medicaid program as a whole.

Managing the Dually Eligible

Medicaid expenditures for the dually eligible in Maryland are delivered via fee-for-service (FFS). Prior attempts to provide more management over this population have not been successful. However, in recent years, more states have begun to look for ways to manage the costs of this population. In early 2016, Medicaid established the Maryland Duals Care Delivery Workgroup to see how the State can best manage this population, especially given the significant work that is going on in the State with regard to management of the Medicare population as a whole through

the Maryland all-payer model contract (see separate issue paper, *Implementation of the All-payer Model Contract*, for more details).

The workgroup considered three potential service delivery models for duals:

- ***Managed FFS Utilizing a Regional Care Coordination Entity and Person-centered Medical Homes*** – similar to models in place in Washington and Colorado;
- ***Dual-eligible Accountable Care Organizations (ACO)*** – while there is little State experience with ACOs for the dually eligible, there is experience in the Medicare arena; and
- ***Capitated Health Plans for Both Medicare and Medicaid Services*** – at least 10 states have some sort of capitated financial alignment demonstration, and Maryland has extensive experience with capitated plans in Medicaid generally.

Ultimately, the workgroup has opted to investigate the implementation of a hybrid system:

- ***Mandatory ACO Enrollment in Four Jurisdictions*** – Baltimore City and Baltimore, Montgomery, and Prince George’s counties home over two-thirds of the dually eligible population. Under this model, ACOs would follow and manage beneficiaries across the care continuum, ensure beneficiaries are engaged with their person-centered health home, integrate all aspects of care (primary care, behavioral health, long-term care, and other specialty care), and oversee outcomes.
- ***Managed FFS in the Rest of the State*** – A program coordination entity would oversee care provided through person-centered health homes, which will serve as a first care source and planning and coordinating entity for care provided by other health care providers.

Conclusion

No final decisions have been made on what will be included in the concept plan to be submitted to the federal government at the end of 2016. Issues that need to be finalized include specific roles and responsibilities of the various care management and care providing entities, the extent of payment for care coordination, how to implement risk sharing under the ACO model (including the phase-in schedule, defining beneficiary risk levels, as well as linking rewards to quality), and how any proposed management models will interact with the many other health system service delivery and payment reforms being implemented around the Medicare population both at the State and national level. Estimating potential savings to Medicaid under any proposal is difficult to assess. At this point, potential implementation is unlikely until calendar 2018 and any savings will not accrue until beyond that.

Health and Health Insurance

Prescription Drug Affordability

Growth in spending on prescription drugs jumped by 12.6% in 2014 and is anticipated to rise by 7.3% annually through 2018. Acceleration in drug spending is attributed to new specialty drug treatments, overall growth in prescription prices, and market exclusivity provided to brand-name drugs. The federal government is under pressure to approve more generic drug applications and take other actions, while state proposals to address the high cost of prescription drugs have mainly focused on pricing transparency.

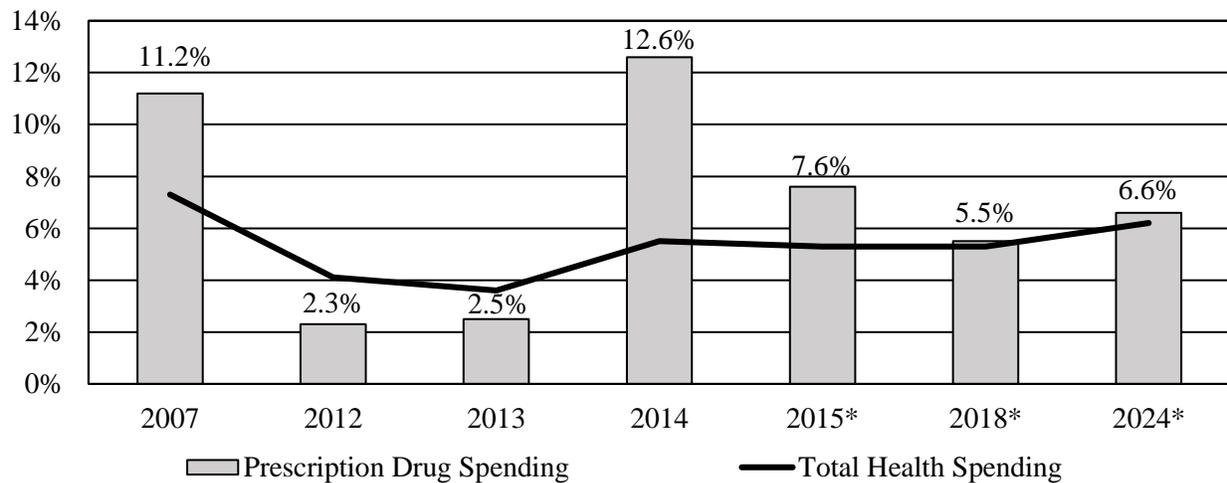
Concerns Regarding Prescription Drug Affordability

Prescription drugs, particularly many new drug products, offer significant clinical benefits to patients. However, the cost of many drugs can place a financial strain on patients who may face high out-of-pocket expenses even if they are insured. The cost of prescription drugs has received considerable attention in recent years in light of notable increases in the price of certain drugs. In 2015, Mr. Martin Shkreli, then Chief Executive Officer of Turing Pharmaceuticals, increased the price of Daraprim (a drug used to treat a specific infection to which individuals with HIV/AIDS or cancer are susceptible) from \$13.50 to \$750.00 per pill. In 2016, an increase in the price of EpiPen (a device that stops potentially fatal allergic reactions by injecting a dose of epinephrine) from less than \$100.00 to more than \$600.00 prompted demands by members of Congress and others for an explanation of the increase. These and other controversial price increases have focused attention on the cost of prescription drugs generally, raised questions about how drug prices are set in the marketplace, and prompted calls for both federal and state action to reduce costs and require drug manufacturers to disclose how drug prices are set.

Rising Expenditures on Prescription Drugs

The U.S. Department of Health and Human Services (HHS) estimates that the United States spent \$457 billion on prescription drugs in 2015, 16.7% of the estimated \$2.7 trillion spent on personal health care services. Of that \$457 billion, \$328 billion was on retail drugs and \$128 billion was for non-retail drugs. **Exhibit 1** shows the rate of spending growth on retail prescription drugs and on total health spending in the United States. Growth in spending on prescription drugs slowed substantially between 2008 and 2012 due to an influx of generic drugs and fewer new brand-name drugs. However, spending rose by 12.6% in 2014 and is estimated to have remained high in 2015.

Exhibit 1
Actual and Projected Growth in Total Health Spending and
Retail Prescription Drug Spending, United States*
2007-2024



*Growth for 2015 to 2024 is projected.

Source: Centers for Medicare and Medicaid Services, Office of the Actuary; National Health Statistics Group

Growth in prescription drug spending is anticipated to rise by an average of 7.3% annually through 2018. With total health spending anticipated to increase at a slower pace of 5.2% between 2013 and 2018 and 6.2% by 2024, prescription drugs are expected to comprise a greater share of all health care spending. HHS projects that total prescription drug spending will reach \$535 billion in 2018, 16.8% of all personal health care spending.

HHS analyzed the factors contributing to the rise in prescription drug spending and attributes 10% of the rise to population growth, 30% to an increase in prescriptions per person, 30% to overall inflation, and 30% to either changes in the composition of drugs prescribed toward higher price products or price increases for drugs that drove price increases in excess of general inflation. Expenditures on specialty drugs, in particular, are increasing and are expected to continue to rise as a share of total health care spending as research and development is increasingly targeted toward these drugs. HHS estimates that spending on specialty drugs increased from \$14.5 billion in 2009 to \$27.1 billion in 2015, an average annual rate of growth of 11%.

An August 2016 special communication in the *Journal of the American Medical Association* found that per capita prescription drug spending in the United States (\$858 in 2013) is more than twice that of 19 advanced industrialized nations (an average of \$400). The study

asserted that market exclusivity of brand-name drugs allows manufacturers to set high prices and that generic drugs are slow to market, delayed by manufacturer business and legal practices.

Federal Proposals to Address the High Cost of Prescription Drugs

Concerns about the high cost of prescription drugs has prompted calls for action to lower prescription drug costs. At the federal level, the EpiPen controversy has prompted calls for approval of more generic versions of common drugs, and the Food and Drug Administration (FDA) is under pressure to reduce a backlog of more than 4,000 generic drug applications. Protected by market exclusivity provisions granted by the U.S. Patent and Trademark Office and FDA, brand-name drugs comprise only 10% of all dispensed prescriptions nationally but account for 72% of drug spending. There are proposals to limit secondary patents for trivial changes of a patented molecule and to lower the exclusivity period for biologic drugs, and well as calls for more aggressive policing of anticompetitive business practices. Other proposals include allowing Medicare to negotiate with drug companies to reduce prices and rein in costs, allowing consumers to import drugs from foreign nations with safety standards that are as strong as U.S. standards, and, for drug companies that receive tax subsidies, requiring more investment in research and development and prohibiting excessive profits and unreasonable marketing expenditures.

State Actions to Address Prescription Drug Costs

State proposals to address the high cost of prescription drugs have mainly focused on requiring transparency in drug pricing. In 2015 and 2016, legislation was considered in 14 states that would require drug manufacturers to report specified information relating to drug pricing and costs. In Virginia, legislation would have required every manufacturer of a prescription drug with a wholesale acquisition cost (list price) of \$10,000 or more for a single course of treatment to report information related to the cost of developing, manufacturing, and marketing the drug. In Vermont, the only state that has enacted drug transparency legislation, manufacturers must provide a justification for price increases on prescription drugs for which the wholesale acquisition cost has increased by 50% or more over the past five years or by 15% or more over the past 12 months. The justification must include all factors that have contributed to a price increase and the role of each factor in contributing to the increase. The information is submitted as a report to the state legislature and posted online.

In November 2016, California considered a ballot measure (Proposition 61, The California Drug Price Relief Act) to restrict the amount that any state agency could pay for prescription drugs by prohibiting the state from paying more than the U.S. Department of Veterans Affairs (VA). VA typically pays the lowest price for prescription drugs of any public or private entity due to a federal law that ensures that VA gets a 24% discount off the drug's list price. The ballot measure was not adopted.

Health and Health Insurance

Implications of the Supreme Court's *N.C. Dental* Decision on State Boards and Commissions

The U.S. Supreme Court's 2015 decision in *N.C. Board of Dental Examiners v. Federal Trade Commission* held that in order to invoke state action immunity from federal antitrust liability, a state board on which a controlling number of decision makers are active market participants must satisfy a two-pronged test: (1) clear articulation of state policy, and (2) active supervision by the state. Senate Bill 1083 was introduced in 2016 to satisfy the active supervision test. The bill was opposed by affected State agencies and did not pass. The Office of the Attorney General has convened a workgroup to attempt to achieve consensus on legislation for introduction in 2017.

Background

In 2015, the U.S. Supreme Court upheld a Federal Trade Commission's order that prohibits the North Carolina State Board of Dental Examiners from preventing nondentists from providing teeth whitening services or products in violation of federal antitrust laws. The *N.C. Board of Dental Examiners v. Federal Trade Commission* decision held that in order to invoke state action immunity from federal antitrust liability, a state board on which a controlling number of decision makers are active market participants must satisfy the two-pronged test established in *California Retail Liquor Dealers Assn. v. Midcal Aluminum Inc.*: (1) clear articulation of state policy, and (2) active supervision by the state.

In an October 1, 2015 memorandum, the Office of the Attorney General (OAG) addressed both prongs of the *Midcal* test as they relate to State licensing boards and commissions. First, the memorandum indicated that the General Assembly has clearly articulated a State policy that a variety of occupations and professions are best regulated by market participants by establishing boards and authorizing them to establish requirements for licensure, issue licenses, and discipline licensees.

Regarding active supervision, the memorandum noted several instances where the adequacy of the State's supervision of boards and commissions could be considered insufficient in light of the *N.C. Dental* decision. The OAG memorandum recommended that a statute be added to the Courts and Judicial Proceedings Article that expresses an intent that boards and their members are immune from antitrust liability for actions taken by the board under certain circumstances. The statute should also (1) emphasize that the secretaries, or their designees, have authority to review regulations and revise or disapprove regulations and actions that would discourage competition, would unfairly restrict entry into a regulated profession or occupation, or are otherwise contrary to public interest; and (2) with respect to contested cases involving anticompetitive concerns or risks, require the secretaries, or their designees, to review and approve board decisions to charge individuals with violations of practice acts.

House Bill 1083 of 2016

House Bill 1083 of 2016 was introduced in response to the *N.C. Dental* decision and the advice of OAG. The bill would have required the secretary of each principal department to adopt regulations for the supervision of each unit of State government within the secretary's jurisdiction that is composed, in whole or in part, of individuals participating in the occupation or profession regulated by the unit in order to (1) prevent unreasonable anticompetitive actions by the unit, and (2) determine whether the decisions and actions of the unit further a clearly articulated State policy to displace competition in the regulated market. The bill also specified the elements that must be included in the regulations and would have altered the power of the Secretary of Health and Mental Hygiene to disapprove or modify decisions of a board or commission under specified circumstances. The bill was opposed by some affected State boards and agencies and did not pass.

Office of the Attorney General Workgroup

In July 2016, the chairs of the Senate Education, Health, and Environmental Affairs Committee (EHE) and the House Health and Government Operations Committee (HGO) sent a letter to Attorney General Brian E. Frosh requesting that OAG convene a workgroup consisting of as many of the stakeholders as possible in order to develop and recommend a legislative solution to the *N.C. Dental* decision that will be met without controversy during the 2017 session. The letter suggested that the workgroup include an examination of:

- the requirements of the *N.C. Dental* decision and what is meant by “active supervision”;
- responses by other states to the *N.C. Dental* decision, including consultation with the Federation of Associations of Regulatory Boards and the National Conference on State Legislatures;
- the policies and regulations currently in place in Maryland to protect boards and commissions against antitrust lawsuits and any modifications that may be needed;
- whether existing oversight statutes, regulations, and policies satisfy the *N.C. Dental* requirements, including language utilized by the Department of Labor, Licensing, and Regulation clarifying that the boards “exercise their powers, duties, and functions subject to the authority of the Secretary”; and
- whether legislation is necessary or if “active supervision” can be accomplished through executive order, administrative changes, or other internal processes.

OAG asked the Maryland Judiciary's Mediation and Conflict Resolution Office to facilitate the workgroup and invited over 40 individuals to participate in four meetings. At the workgroup's first meeting, the workgroup identified and prioritized eight issues to discuss. The issues in order of priority are (1) identifying narrowly sufficient solutions, which may include regulations,

policies, or legislation; (2) providing indemnification for board members and staff; (3) limiting active supervision to anticompetitive actions; (4) identifying solutions that do not politicize the review process; (5) resolving disputes with unlicensed practitioners or unregulated practitioners; (6) determining need for independent review; (7) defining anticompetitive actions; and (8) defining active supervision. Through discussion of the issues at the second meeting of the workgroup, stakeholders expressed different opinions on the degree of active supervision necessary to satisfy the *N.C. Dental* decision and who should perform the supervision. The general consensus at the end of the meeting was that one solution may not fit all. The moderator of the workgroup directed the workgroup members with similar ideas on satisfying the requirements of the *N.C. Dental* decision to work together to create a solution from their perspective before the next meeting. At the third meeting, the workgroup divided into two groups based on the proposed solutions. One group focused on solutions that provided active supervision within a department by the secretary or the secretary's designee. The other group focused on solutions that provided active supervision from a nonpolitical entity located outside of a department. The workgroup's final meeting took place in late November 2016 and the workgroup's recommendations will be reported to the EHE and HGO committees in December 2016.

Health and Health Insurance

Alterations to the Maryland Patient Referral Law to Promote Value-based Payments and Provider Collaboration

The Maryland Patient Referral Law (MPRL), which prohibits health care practitioners from referring a patient to a health care entity with which the health care practitioner has a compensation arrangement or a beneficial interest, was enacted in 1993 when fee-for-service was the predominant method of payment. Medicare reimbursement is shifting from fee-for-service to value-based payment, and the State's all-payer model contract with the federal government needs to be amended to promote greater collaboration among providers. A workgroup convened during the 2016 interim found consensus on the need to modernize the MPRL to protect and encourage Medicare payment models but was unable to reach consensus on a specific method to protect referrals made under the new models.

Prohibition on Self-referral Countered Fee-for-service Incentives

Under the Maryland Patient Referral Law (MPRL), a health care practitioner may not refer a patient to a health care entity with which the health care practitioner has a compensation arrangement or a beneficial interest. Enacted in 1993 when fee-for-service was the predominant method of payment, the MPRL addressed concerns about a potential conflict of interest and overutilization of health care services when a health care practitioner refers patients to health care entities in which the health care practitioner has a financial interest. The law is similar to, but broader than, the federal Stark law that prohibits certain types of self-referral in the Medicare and Medicaid programs.

New Payment Methods Are Replacing Fee-for-service

In recent years, new and innovative payment methods have begun to replace fee-for-service. The federal Medicare Access and CHIP Reauthorization Act of 2015 seeks to move 80% of Medicare reimbursement away from fee-for-service reimbursement to value-based payment by 2018. Value-based payment rewards health care providers for better care management and patient outcomes. The federal government will waive the Stark law prohibition on self-referral for provider arrangements that closely manage care and improve quality. These provider arrangements also require physicians and hospitals to coordinate and align their care delivery. Commercial payers are also developing their own value-based payments for physician services.

Proposed Changes to the MPRL Promote Alignment of Care among Providers

In 2015, the Maryland Health Care Commission convened a workgroup to examine possible changes to the MPRL. While the workgroup did not make specific recommendations, it did achieve consensus on the need to modernize the law to (1) allow for the development of additional bona fide value-based payment models, risk-sharing arrangements, and alignment models; and (2) ensure emerging compensation arrangements are permissible.

Senate Bill 886/House Bill 1272 of 2016 would have exempted “collaborations to promote provider alignment” from general prohibitions against self-referrals by health care practitioners and required disclosures of beneficial interests. Collaborations to promote provider alignment was defined as collaborations that (1) involve the distribution, either directly or indirectly through a contract, of compensation that is attributable to specified arrangements or value-based payment models; (2) promote accountability for the overall care of patients; and (3) encourage investment in redesigned care processes for high quality and efficient service delivery to patients. The purpose of collaborations was to promote provider alignment to achieve the goals of Maryland’s all-payer model contract.

Provider Alignment Workgroup

Although the bills failed, the chair of the House Health and Government Operations Committee requested that the Maryland Hospital Association and the Patient Care and Access Coalition convene a workgroup during the 2016 interim to attempt to achieve consensus on legislation to exempt collaborations to promote provider alignment from the prohibition on self-referral. The workgroup, comprised of representatives of hospitals, physician groups, commercial payers, and government agencies, met six times. While the workgroup found some areas of agreement, it was unable to reach consensus on legislation.

According to the draft report of the workgroup, there was general consensus that the MPRL should not impede current or future Medicare payment models, but rather that Maryland law should protect and encourage these models. Despite this consensus, workgroup members differed on the precise method by which referrals for health care services made within the context of financial relationships under any new federally created models should be protected. Areas of disagreement included the need for a separate State approval process for provider relationships under the federal payment models and the need to prohibit certain kinds of provider integration.

Extension of MPRL protection for referrals made by health care practitioners in commercial models that are structured consistent with the approved federal models was another area of controversy. Some workgroup members favored stronger consumer protections, such as notice to patients and protection from balance billing by health care practitioners participating in these commercial models.

Modifications to the MPRL have developed greater urgency due to the State's all-payer model contract with the federal Center for Medicare and Medicaid Innovation (CMMI). The all-payer model requires the State to submit changes to CMMI by December 31, 2016. The Health Services Cost Review Commission advises that shared savings compensation arrangements between hospitals and physicians approved by CMMI could still violate State law unless the MPRL is modified.

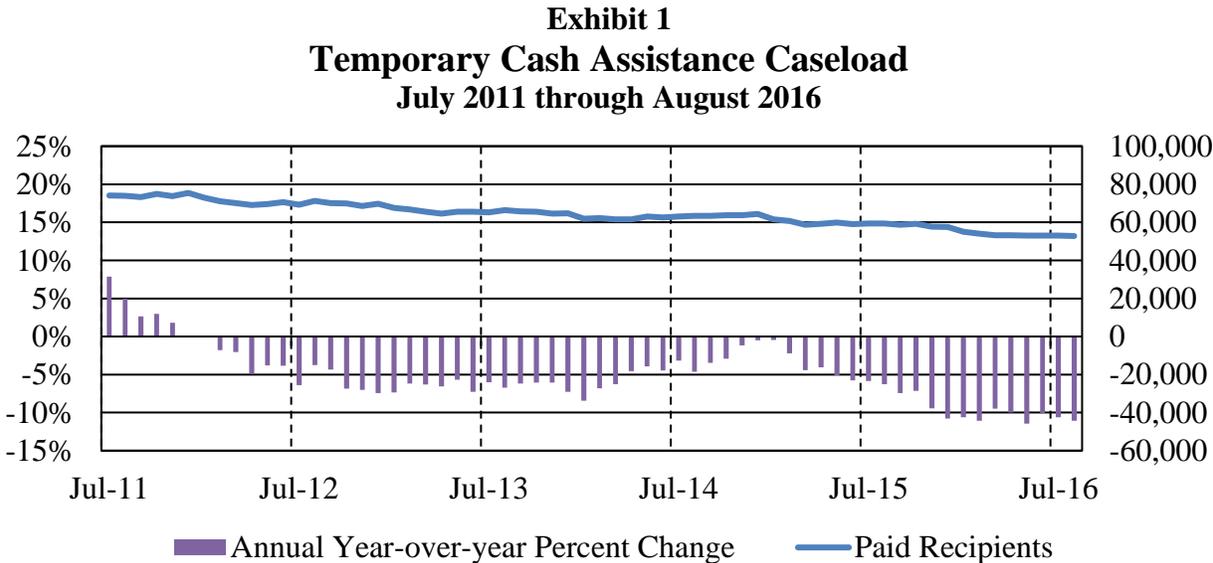
Human Services

Public Assistance Caseload Trends

The Temporary Cash Assistance (TCA) caseload continued to decline in fiscal 2016 and is projected to continue to decline in fiscal 2017 and 2018, with small increases in the average monthly grant amount. A \$9.3 million TCA general fund surplus is anticipated for fiscal 2017. The number of Marylanders receiving Supplemental Nutrition Assistance Program (SNAP) benefits also continued to decline for the second year in a row. In October 2016, the Department of Human Resources began providing a new supplemental benefit to ensure that certain households get a minimum SNAP benefit of \$30 per month.

Temporary Cash Assistance Caseload and Funding Trends

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or caretaker relatives and is funded with general funds, federal Temporary Assistance for Needy Families block grant dollars, and certain child support collections. As shown in **Exhibit 1**, the most recent peak in the TCA caseload occurred in December 2011 (75,442 recipients). However, the caseload has declined on a year-over-year basis in all months since January 2012. In August 2016, the number of TCA recipients was 52,797, a 30.0% decrease from the December 2011 peak, and 11.1% lower than August 2015.



Source: Department of Human Resources; Department of Legislative Services

As shown in **Exhibit 2**, the Department of Legislative Services (DLS) projects average monthly enrollment in TCA to continue to decline in fiscal 2017 and 2018. Despite a small increase in the average monthly grant in each year to account for changes in the Maryland Minimum Living Level, DLS projects that the amount of general funds needed to fund TCA in fiscal 2017 will be less than the \$21.6 million included in the fiscal 2017 appropriation after accounting for a reduction taken by the Board of Public Works on November 2, 2016, resulting in an anticipated general fund surplus for TCA of \$9.3 million. TCA general fund expenditures are expected to continue to decline in fiscal 2018.

Exhibit 2
Temporary Cash Assistance Enrollment and Funding Trends
Fiscal 2016-2018

	<u>2016</u> <u>Actual</u>	<u>2017</u> <u>Approp.</u>	<u>2017</u> <u>Estimate</u>	<u>2018</u> <u>Estimate</u>	<u>% Change</u> <u>2017-2018</u>
Average Monthly Enrollment	56,115	57,768	51,649	48,950	-5.2%
Average Monthly Grant	\$192.65	\$192.30	\$194.10	\$195.55	0.8%
Budgeted Funds in Millions					
General Funds	\$12.1	\$21.6 ¹	\$12.3	\$8.2	-33.7%
Total Funds	\$129.7	\$133.3	\$120.3	\$114.9	-4.5%
Estimated Surplus			\$9.3		

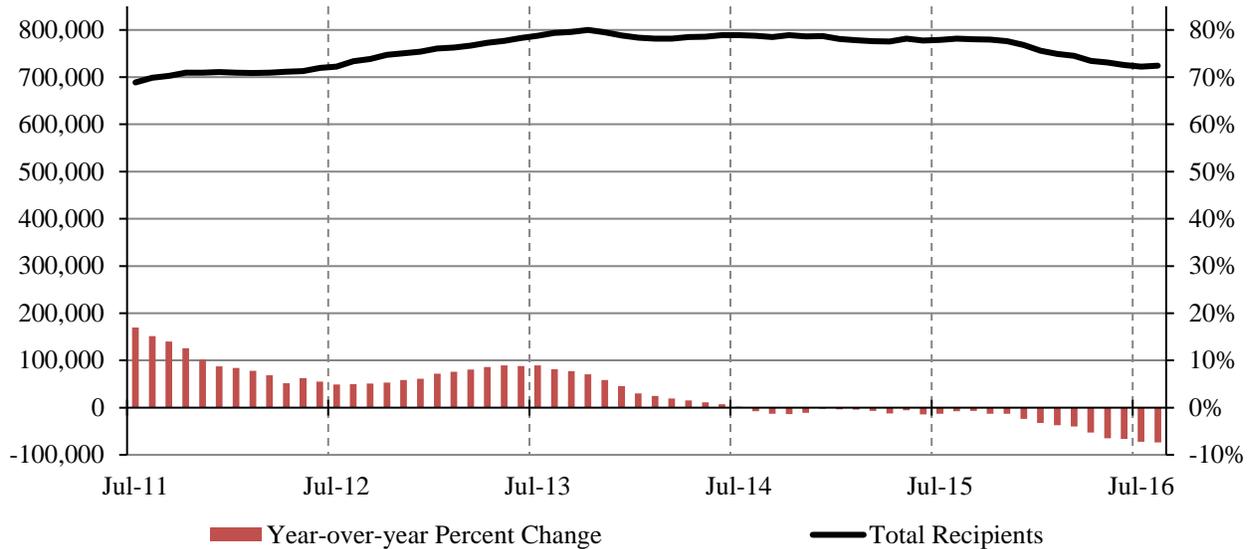
¹Reflects a reduction take by the Board of Public Works on November 2, 2016.

Source: Department of Human Resources; Department of Legislative Services

Supplemental Nutrition Assistance Program Caseload Trends

The Supplemental Nutrition Assistance Program (SNAP) helps low-income people buy the food that they need for good health. Benefits are provided entirely with federal funds, with administrative costs shared between the State and federal government. Due to a combination of the economy and outreach efforts, the SNAP caseload substantially increased through October 2013 to a peak of 800,222. As shown in **Exhibit 3**, the caseload has generally decreased since that time, declining on a year-over-year basis in all months from August 2014 through August 2016.

**Exhibit 3
Supplemental Nutrition Assistance Program Caseload
July 2011 through August 2016**



Source: Department of Human Resources; Department of Legislative Services

In fiscal 2016, SNAP benefit expenditures were \$1.1 billion, a decrease of \$44.6 million over fiscal 2015. In August 2016, the number of recipients was 724,104, 9.5% lower than the peak and 7.3% lower than August 2015.

New State Supplemental SNAP Benefit

The federal minimum monthly SNAP benefit level is \$16. Chapter 696 of 2016 requires Maryland to ensure that all households that include an individual who is at least age 62 receiving SNAP benefits get a minimum benefit of \$30 per month by providing a supplemental benefit if necessary.

In October 2016, the Department of Human Resources began issuing this new supplemental benefit, using State general funds to pay the difference between the \$16 federal minimum benefit and the \$30 State minimum benefit. The supplemental benefit is expected to impact 17,999 households, providing a total benefit of \$2.1 million in fiscal 2017 and \$2.9 million in fiscal 2018 (when the benefit is available for the full calendar year). Households will not need to separately apply for this supplemental benefit.

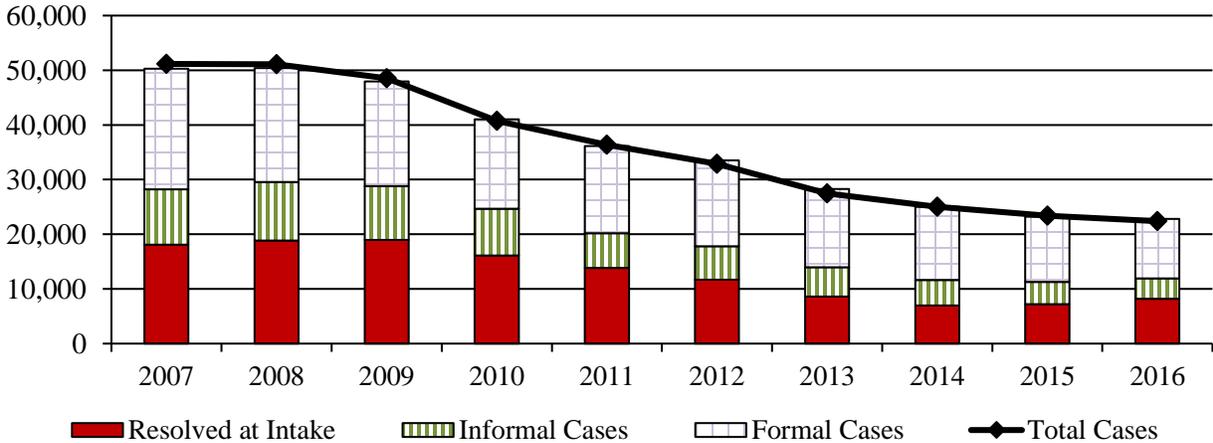
Department of Juvenile Services Caseload Trends

The number of youth in the juvenile justice system continues to decline due to fewer referrals and targeted efforts by the Department of Juvenile Services (DJS). The number of juvenile complaints declined to less than 23,000 in fiscal 2016, with a greater proportion of cases resolved at intake. Out-of-home commitments continued to drop, with sharp declines for the committed care population. The overall detention population has decreased more slowly due to an increase in the number of youth being held while awaiting action from the adult court system. This population now accounts for 28% of the total population in secure detention and has a significantly longer average length of stay.

Juvenile Complaints Continue to Decline

Exhibit 1 details the total number of complaints received by the Department of Juvenile Services (DJS) in the past decade, as well as complaint disposition.

Exhibit 1
Juvenile Complaints and Complaint Dispositions
Fiscal 2007-2016



Note: Total complaints typically are 1% to 2% higher than the sum of those resolved at intake and the informal and formal caseload. The difference relates to jurisdictional issues or cases in which a decision is not recorded.

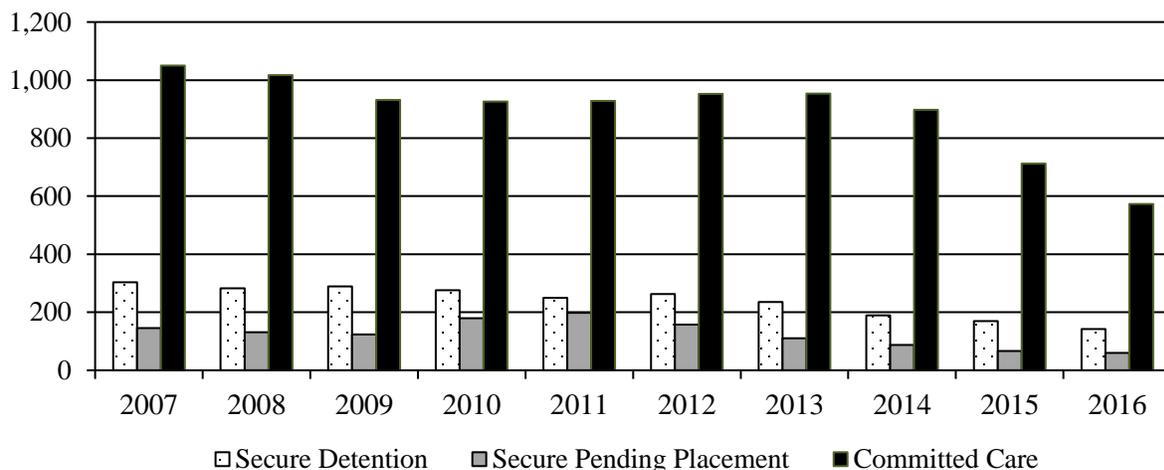
Source: Department of Juvenile Services; Department of Legislative Services

The downward trend in the number of youth referred to DJS continued through fiscal 2016, in part due to a more than 12% decline in the number of juvenile arrests in Maryland in calendar 2015. In fiscal 2016, cases resolved at intake increased to 37% of all referrals to the department (from 31% in fiscal 2015) due to DJS working internally and with stakeholders to ensure that youth are not unnecessarily entering the juvenile justice system and/or being placed in secure detention. Also in fiscal 2016, the total number of cases resolved at intake increased by 14%, while referrals involving some level of intervention (informal or formal) each decreased by 9%.

Average Daily Population in Residential Placements Decreasing

Fewer referrals, reductions in pending placement, and efforts to limit the doors to detention, such as the increased use of alternative-to-detention programming and alternative/graduated sanctions for supervised youth in lieu of secure detention, have resulted in fewer out-of-home placements. **Exhibit 2** provides average daily population (ADP) trends for certain pre- and post-disposition residential placements. In fiscal 2016, an ADP of 202 juvenile court involved youth were held in DJS detention facilities, a 14% reduction compared to fiscal 2015 and a 55% decrease compared to a decade ago when the detention ADP was 448 youth.

Exhibit 2
Selected Average Daily Population Trends
Fiscal 2007-2016



Note: Secure detention does not include the youth charged as adult population.

Source: Department of Juvenile Services; Department of Legislative Services

Efforts to increase the use of community-based treatment and reduce the number of youth inappropriately placed in out-of-home care have begun to reduce the committed care population.

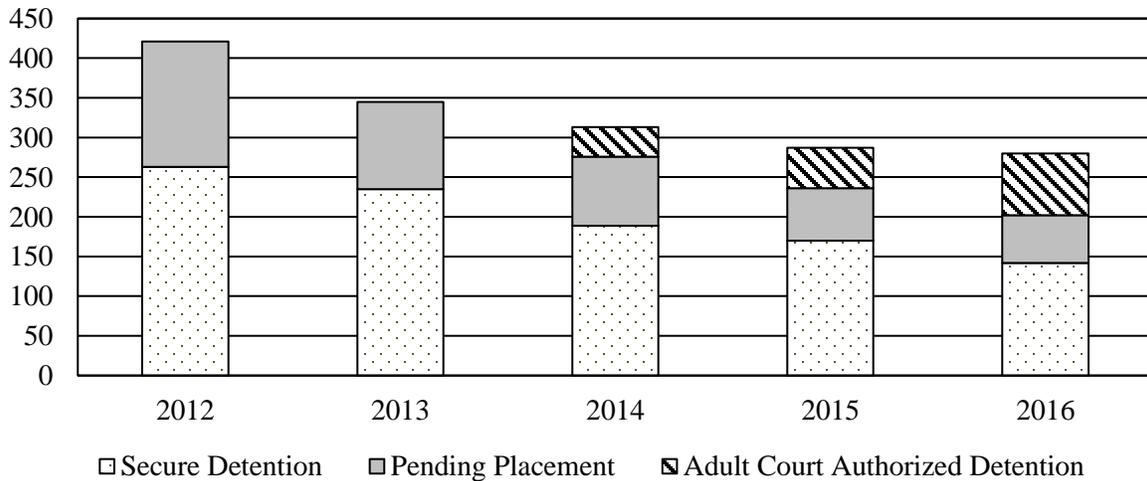
The ADP of 573 youth in committed residential placements in fiscal 2016 reflects the second year of declines of at least 20% in this population.

Number of Adult Court Authorized Youth in Detention Increasing

Legislation enacted in 2015 requires that, in most cases, a 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 transfer. Since DJS first began accepting this population in fiscal 2014 under an agreement entered into with Baltimore City prior to the passage of the legislation, the ADP for these youth has increased 53%. In fiscal 2016, this population accounted for 28% of the total population in secure detention. Although the population of juvenile court involved youth in secure detention has fallen 52% since 2012, the overall detention population has only fallen 33%, as DJS has absorbed more youth whose secure detention is authorized by the adult court system.

Exhibit 3 illustrates the total ADP for youth held in DJS detention facilities since fiscal 2012, including youth awaiting action from the adult court system. These youth typically have an average length of stay in excess of 90 days, nearly six times longer than pre-disposition youth. To the extent that the traditional detention ADP remains low, capacity for the adult court involved population is not a concern; however, the longer length of stay creates unique needs to be addressed.

**Exhibit 3
Detention Facilities Average Daily Population
Fiscal 2012-2016**



Source: Department of Juvenile Services; Department of Legislative Services

Provider Rates Low and Parent Copayment High

Provider subsidy rates are set by region, type of care, and age of child, based on a survey of market rates charged by providers. Providers may also receive supplemental payments for obtaining specific quality ratings under Maryland EXCELS, a tiered quality rating and improvement system for child care and early education programs. Federal regulations recommend that subsidy rates be set at the seventy-fifth percentile of current market rates, although only one state (South Dakota) meets this benchmark. Maryland's rates are only at the ninth percentile of market rates, down from the twenty-third percentile in 2010 to 2011.

Families receiving a subsidy are assigned a copayment based on a sliding fee schedule. Families eligible for Temporary Cash Assistance and Supplemental Security Income have no copayment. Copayments currently range from 5% to 50% of the cost of care for the first child and 3% to 40% for the second and third child in care. Federal regulations recommend that parent copayments be no more than 7% of family income. Maryland's average copayment was 15% of family income in fiscal 2015; MSDE capped copayments at 12% of family income beginning in fiscal 2016.

Federal Re-authorization Requires Action

CCDF regulations set out key benchmarks for states, some required and some guidelines, to promote affordability, accessibility, parental choice, and quality. Federal re-authorization of the CCDF (finalized in September 2016) has adjusted benchmarks and imposed new requirements, some of which will impact Maryland's CCS program and require additional general fund spending.

- States must establish a minimum 12-month eligibility period for families receiving child care subsidies to reduce churn, allow children to benefit from continuous care, and lower administrative burdens. MSDE estimates that a minimum 12-month eligibility will cost \$24.4 million in fiscal 2017 and \$43.3 million in fiscal 2018.
- States must have two-tiered income eligibility with an initial, entry-level income below 85% of the State median income and a higher exit-level income to allow a tapered transition from the program.
- Family copayments should be no more than 7% of family income (down from the previous 10% benchmark).
- States should set provider rates that allow for equal access (with a benchmark at the seventy-fifth percentile of current market rates). MSDE estimates that increasing provider rates would cost an estimated \$42.3 million (to fiftieth percentile), \$52.2 million (to sixtieth percentile), or \$68.3 million (to seventy-fifth percentile).
- States must increase the amount of CCDF funds they spend to improve the quality of child care from 4% to 9% by 2020 and spend at least 3% of CCDF funds on improving the quality of infant and toddler care.

Exhibit 2 summarizes key federal benchmarks and new requirements under re-authorization, compared with current Maryland policies.

Exhibit 2
Key Federal Benchmarks and New Requirements under
Federal Re-authorization of the Child Care Development Fund

	<u>Old Benchmark/ Requirement</u>	<u>New Benchmark/ Requirement</u>	<u>Maryland</u>
Subsidy Rates	Provider rates should ideally be set at the seventy-fifth percentile of market rates	Rates should allow for equal access and parental choice; rates should ideally be set at the seventy-fifth percentile of market rates	Provider rates are set at the ninth percentile of market rates
Copayments	Parent copayments should not exceed 10% of family income	Parent copayments should not exceed 7% of family income	Copayments are capped at 12% of family income
Income Eligibility	Must be less than 85% of State median income (SMI)	Must be less than 85% of SMI for initial eligibility, with a higher, exit-level income	Maximum eligibility level for a family of three is 41% of SMI (35% under current enrollment freeze); no higher, exit-level income level
Eligibility Period	n/a	Minimum 12-month eligibility period for families receiving subsidies	Current practice has been 30-day, 6-month, and 12-month eligibility periods
Quality Spending	States must spend at least 4% of Child Care Development Fund (CCDF) funds on quality	Must spend at least 9% of CCDF funds on quality by 2020	Maryland currently spends 12% of CCDF funds on quality

Source: Department of Legislative Services

Additional detail on Maryland's CCS and child care affordability in Maryland will be available in a report to be published by the Department of Legislative Services in December 2016.

Transportation

Overview of the Draft 2017-2022 Consolidated Transportation Program

The Maryland Department of Transportation's draft 2017-2022 Consolidated Transportation Program (CTP) lists all capital projects funded in the current fiscal year and those planned for the next five years. Spending over the six-year period of the draft 2017-2022 CTP totals \$14.4 billion, a \$1.3 billion decrease from the 2016-2021 CTP.

Overview

The Consolidated Transportation Program (CTP) is Maryland's six-year capital budget for transportation projects. It is updated annually and includes all major and minor capital projects that the Maryland Department of Transportation (MDOT), its modal administrations, and the Washington Metropolitan Area Transit Authority (WMATA) are undertaking in the current year and over the next five-year planning period. Capital projects for the Maryland Transportation Authority are also included in the CTP but are excluded from this analysis. **Exhibit 1** compares six-year spending contained in the 2016-2021 CTP to the draft 2017-2022 CTP by fund source.

Exhibit 1 Comparison of Six-year Capital Spending by Fund Source Fiscal 2016-2022 (\$ in Millions)

	<u>2016-2021 CTP</u>	<u>Draft 2017-2022 CTP</u>	<u>Change</u>	<u>% Change</u>
Special Funds	\$9,535.5	\$8,397.1	-\$1,138.4	-11.9%
Federal Funds	4,956.5	4,968.5	12.0	0.2%
Other Funds*	1,213.5	1,080.1	-133.4	-11.0%
Total Funds	\$15,705.5	\$14,445.7	-\$1,259.8	-8.0%

CTP: Consolidated Transportation Program

*Other funds include funds from customer and passenger facility charges and certain types of federal aid that do not pass through the Transportation Trust Fund.

Note: Numbers may not sum due to rounding.

Source: Maryland Department of Transportation 2016-2021 CTP, draft 2017-2022 CTP

The total funding level in the draft 2017-2022 CTP decreases by \$1.3 billion (-8.0%) from the 2016-2021 CTP. This net decrease results from decreases in special funds and other funds only slightly offset by an increase in federal funds. Special funds available for the capital program

decrease due to (1) a write-down in projected revenues to reflect an expectation that gas prices will not increase significantly during the forecast period; (2) increasing debt service levels reflecting the increased reliance on debt to support the capital program; and (3) an increase in estimated level of operating expenses to more closely align with the average rate of growth in the cost of departmental operations.

Exhibit 2 compares MDOT's total capital spending in each plan by mode. In the draft 2017-2022 CTP, State highways receives 52.7% of total capital funding, and mass transit (including both the Maryland Transit Administration and WMATA) receives 36.0% of the funding.

Exhibit 2
Comparison of Six-year Capital Spending by Mode
Fiscal 2016-2022
(\$ in Millions)

	<u>2016-2021 CTP</u>	<u>Draft 2017-2022 CTP</u>	<u>Change</u>	<u>% Change</u>
Secretary's Office	\$334.3	\$246.4	-\$87.9	-26.3%
WMATA	1,581.3	1,583.7	1.7	0.1%
State Highways	8,363.4	7,605.8	-757.6	-9.1%
Port	909.4	852.2	-57.2	-6.3%
Motor Vehicle	133.9	125.1	-8.8	-6.6%
Mass Transit	3,744.0	3,620.3	-123.7	-3.3%
Airport	639.2	412.2	-227.0	-35.5%
Total	\$15,705.4	\$14,445.7	-\$1,259.7	-8.0%

CTP: Consolidated Transportation Program

WMATA: Washington Metropolitan Area Transit Authority

Note: Numbers may not sum due to rounding.

Source: Maryland Department of Transportation 2016-2021 CTP, draft 2017-2022 CTP

The largest percent decreases occur in the modes of airport (-35.5%), which includes the two public airports in the State, and in the Secretary's Office (-26.3%). A majority of the reduction in the airport capital program results from the completion of several large projects located at the Baltimore-Washington International (BWI) Thurgood Marshall Airport, such as the connector between concourses D and E (-\$61.4 million) and the runway safety area, standards and pavement improvements (Phases 2 through 4). Almost 70.0% of the reduction to the Secretary's Office is a reduction to system preservation and minor projects.

Exhibit 3 compares MDOT's six-year capital spending in each plan by category. The largest dollar decreases occur in funding for major projects (-\$719.8 million) and system

preservation/minor projects (-\$460.3 million). On a percent change basis, funding for the Development and Evaluation Program sees the largest decrease with a 31.7% decrease in funding between the two CTPs. Funding for major projects and system preservation/minor projects decreases by 8.7% and 7.2%, respectively. Almost half the major projects reductions occur in State highways with another 24.0% of the reduction in airport funding due to the projects at BWI discussed above. Over two-thirds of the reduction in the Development and Evaluation Program also occurs in State highways.

Exhibit 3
Comparison of Six-year Capital Spending by Category
Fiscal 2016-2022
(\$ in Millions)

	2016-2021	Draft 2017-2022		
	<u>CTP</u>	<u>CTP</u>	<u>Change</u>	<u>% Change</u>
Major Projects	\$8,263.6	\$7,543.8	-\$719.8	-8.7%
System Preservation/Minor Projects	6,374.7	5,914.4	-460.3	-7.2%
Development and Evaluation Program	327.2	223.6	-103.6	-31.7%
Other	739.4	764.1	24.7	3.3%
Total	\$15,705.4	\$14,445.7	-1,259.7	-8.0%

CTP: *Consolidated Transportation Program*

Note: Numbers may not sum due to rounding.

Source: Maryland Department of Transportation 2016-2021 CTP, draft 2017-2022 CTP

Transportation

Transportation Prioritization in Other States

The Maryland Open Transportation Investment Decision Act of 2016 (Chapter 36) established State transportation goals and measures to prioritize how major transportation projects are funded in the State. Prior to the enactment of Chapter 36, North Carolina, Massachusetts, and Virginia had already enacted similar legislation. While there are differences in the legislation enacted in each of these states, they do share common purposes with Chapter 36 – to establish transportation goals or measures, and to varying degrees, require that transportation projects be prioritized in accordance with these goals or measures.

Background

During the legislative session of 2016, Maryland enacted Chapter 36, which establishes State transportation goals and measures that must be used to evaluate whether, and to what extent, certain transportation projects meet the goals. The goals established under Chapter 36 are (1) safety and security; (2) system preservation; (3) quality of service; (4) environmental stewardship; (5) community vitality; (6) economic prosperity; (7) equitable access to transportation; (8) cost effectiveness and return on investment; and (9) local priorities and planning. Each goal must be scored using detailed measures that are outlined in Chapter 36. Using the goals and measures established under the Act, the Maryland Department of Transportation (MDOT) must adopt regulations that implement a project-based scoring system.

The project-based scoring system applies only to major capital projects in the State Highway Administration or the Maryland Transit Administration whose total cost for all phases exceeds \$5.0 million and that (1) increases highway or transit capacity; (2) improves transit stations or station areas; or (3) improves highway capacity through the use of intelligent transportation systems or congestion management systems. Projects with higher scores must be prioritized for inclusion in the *Consolidated Transportation Program (CTP)* over projects with lower scores; however, MDOT may include a project with a lower score in the CTP over a project with a higher score if it provides in writing a rational basis for the decision. The regulations to implement the scoring system and weighting metrics must be adopted by January 1, 2017.

North Carolina

North Carolina enacted S.L. 2013-183, known as the Strategic Transportation Investments law, in 2013. The legislation divides projects into three categories based on the type of project, which are then allocated a certain percentage of transportation funds: (1) Division Needs projects, which receive 30% of available revenue; (2) Regional Impact projects, which receive 30% of available revenue; and (3) Statewide Mobility projects, which receive 40% of available revenue. Within each category, each project is ranked pursuant to specified criteria, and, depending on the

project category, each criterion is weighted differently. Alternative criteria may also be established to take into account the unique needs of a particular division or region if certain parties agree in the adoption of the criteria. **Exhibit 1** illustrates the criteria and corresponding weights used to score a project in each project category. These scores and other factors are used to determine whether a project receives funding. North Carolina's new scoring system was first used by the North Carolina Department of Transportation to compile the 2016-2025 State Transportation Improvement Program.

Exhibit 1
North Carolina Project Scoring Criteria

<u>Criteria</u>	<u>Division Needs Projects</u>	<u>Regional Impact Projects</u>	<u>Statewide Mobility Projects</u>
Local Input	50%	30%	n/a
Congestion	15%	20%	30%
Benefit/Cost	10%	20%	25%
Safety	5%	10%	15%
Freight and Military	5%	10%	15%
Accessibility/Connectivity	5%	10%	n/a
Multimodal and Military	n/a	n/a	5%

Source: North Carolina Department of Transportation

Massachusetts

In 2013, Massachusetts enacted Chapter 46 which established a Project Selection Advisory Council and required the council to develop a transportation prioritization scoring system. The Massachusetts Department of Transportation (MassDOT) is ultimately responsible for implementing the scoring system. In July 2015, after multiple public hearings, the council made its recommendations regarding prioritization.

The council recommended dividing transportation projects into the following six scoring system categories: (1) Roads and Paths Modernization; (2) Roads and Paths Capacity; (3) Massachusetts Bay Transportation Authority (MBTA) Modernization; (4) MBTA Capacity; (5) Regional Transit Modernization; and (6) Regional Transit Capacity. Within each category, each project is ranked pursuant to specified criteria, and, depending on the scoring system category, each criterion is weighted differently. **Exhibit 2** illustrates the criteria and corresponding weights used to score a project in each scoring system category.

Projects are scored at the project initiation phase and annually thereafter to ensure that significant project modifications are reflected in a project's score. The scoring system applies only to projects that modernize or expand the capacity of the existing transportation infrastructure.

MassDOT is not required to fund only the highest scoring projects and may reallocate funding if the scoring system creates an imbalance in funding by region.

Implementation is scheduled to begin in 2017.

Exhibit 2
Massachusetts Project Scoring Criteria

<u>Criteria</u>	<u>Roads and Paths Modernization</u>	<u>MBTA/Regional Transit Modernization</u>	<u>Roads and Paths Capacity</u>	<u>MBTA/Regional Transit Capacity</u>
Cost Effectiveness	15%	20%	20%	25%
Economic Impact	10%	n/a	15%	20%
Environmental and Health Effects	10%	5%	10%	10%
Mobility	10%	30%	25%	25%
Policy Support	10%	10%	10%	10%
Safety	10%	10%	10%	n/a
Social Equity	n/a	n/a	10%	10%
System Preservation	35%	25%	n/a	n/a

MBTA: Massachusetts Bay Transportation Authority

Source: *Recommendations for MassDOT Project Selection Criteria*, Project Selection Advisory Council Report to the Legislature, July 1, 2015

Virginia

Enacted in 2014, Chapter 726, known as House Bill 2, significantly altered Virginia's transportation prioritization process. The Act directed Virginia's Commonwealth Transportation Board (CTB), a 17-member body appointed by the Governor, to establish a transportation scoring system that considers, at a minimum, the following factors relative to the cost of the project: (1) congestion mitigation; (2) economic development; (3) accessibility; (4) safety; (5) environmental quality; and (6) land use coordination in areas with a population over 200,000. CTB assigns the weighting and measures of each factor and may assign different weighting typologies to account for the unique needs and qualities of a particular region. Project scoring applies only to capacity and operational improvements. **Exhibit 3** illustrates CTB's most recent weighting typologies as they apply to different regions (categorized by letter), as well as the weighting of each measure for the scoring of each factor.

Projects are evaluated and scored by the Virginia Department of Transportation and Virginia's Department of Rail and Public Transportation using the scoring system established by CTB. Once scoring and evaluation is complete, CTB chooses which projects to include in its Six-year Improvement Program (SYIP). A project may be rescored if there is significant change

in the project's funding or scope. CTB may include a project with a lower score in the SYIP over a project with a higher score if it provides a rational basis for the decision.

Virginia's new scoring system was first used by CTB in June 2016.

Exhibit 3
Virginia Project Scoring Factors, Measures, and Weighting

<u>Factor</u>	<u>Category A</u>	<u>Category B</u>	<u>Category C</u>	<u>Category D</u>
Congestion Mitigation	45%	15%	15%	10%
Economic Development	5%	20%	25%	35%
Accessibility	15%	25%	25%	15%
Safety	5%	20%	25%	30%
Environmental Quality	10%	10%	10%	10%
Land Use	20%	10%	n/a	n/a

Measures and Weighting

Congestion Mitigation	Person Throughput (50%) Person Hours of Delay (50%)
Economic Development	Project Support for Economic Development (60%) Intermodal Access and Efficiency (20%) Travel Time Reliability (20%)
Accessibility	Access to Jobs (60%) Access to Jobs for Disadvantaged Persons (20%) Access to Multimodal Choices (20%)
Safety	Number of Fatal and Injury Crashes (50%) Rate of Fatal and Injury Crashes (50%)
Environmental Quality	Air Quality and Environmental Effect (50%) Impact to Natural and Cultural Resources (50%)
Land Use (Areas over 200,000 in Population)	Transportation-efficient Land Use (100%)

Source: *SMART SCALE Policy Guide*, compiled by the Virginia Office of Intermodal Planning and Investment, Virginia Department of Rail and Public Transportation, and the Virginia Department of Transportation; *HB2 Implementation Policy Guide*, prepared for Virginia's Commonwealth Transportation Board, August 1, 2015

Business Regulation

Unemployment Insurance

With the continued employment growth in the State and lower claims activity, the balance of the Unemployment Insurance Trust Fund is at a level that allows Maryland employers to continue to pay from the lowest cost table in calendar 2017. Maryland's unemployment rate improved to 4.3% from 5.1% a year ago. The maximum weekly benefit amount has not been increased since 2010. The Joint Committee on Unemployment Insurance Oversight plans to discuss the status of unemployment insurance in Maryland during the 2017 session.

Background

Unemployment insurance (UI) provides temporary, partial wage replacement benefits to persons who are unemployed through no fault of their own and who are willing to work, able to work, and actively seeking employment. Funding for the program is provided by employers through UI taxes paid to both the federal government for administrative expenses and to the states for deposit in their respective UI trust funds.

The UI Trust Fund and Outlook for Employer Taxes in Calendar 2017

Legislation enacted in Maryland in 2005 altered Maryland's UI charging and taxation system by creating a series of experience tax rate tables that are based on the balance in the Maryland UI trust fund. An employer's unemployment experience determines the rate charged within each table. Generally, the balance of the UI trust fund relative to total taxable wages in the State determines the tax rate table for a given year. If the balance of the UI trust fund exceeds 5% of total taxable wages in the State (as measured on September 30 of the current year), the lowest tax rate table (Table A) is used to calculate employer rates for the following calendar year. Lower trust fund balances require higher tax rate tables. The highest tax table (Table F) is used when the balance of the UI trust fund is not in excess of 3% of the total taxable wages. In Table A, employers pay a minimum of 0.3% (on the first \$8,500 of annual wages of each employee) and a maximum of 7.5% (\$25.50 to \$637.50 per employee). In Table F, employers pay a minimum of 2.2% and a maximum of 13.5% (\$187 to \$1,147.50 per employee).

While total taxable wages are the general determinant for the rate tables, Chapter 337 of 2016 requires certain federal funding requirements to be met in order for a lower UI tax rate table to apply in a following calendar year (for example, moving from Table B to Table A). The new federal requirements specify that each state must have a sufficient trust fund balance based on its historical highest payout period. Failure to meet the new funding requirement will result in an interest-bearing loan from the U.S. Treasury in the event that a state must borrow to pay UI benefits (which can happen during a recession). Payment of the interest due on such a

loan must come from state general funds – not UI taxes. The funding requirement is phased in from 2014 (which started at 50% of the full funding goal) through 2018, increasing by 10% each year. The Department of Labor, Licensing, and Regulation anticipates that the trust fund balance necessary to meet the full requirement is approximately \$1.5 billion.

The federal unemployment tax under the Federal Unemployment Tax Act (FUTA) is assessed on the first \$7,000 of annual wages of each employee. The standard FUTA tax rate for employers is 6.0%, but the rate is subject to an offset credit of up to 5.4% for employers who pay their state unemployment taxes on time. Employers in states that have received but not repaid loans from the federal government (called “credit reduction states”) receive a lower offset credit and pay higher FUTA taxes. Employers in Maryland (Maryland does not have an outstanding loan) receive the full 5.4% offset credit and pay a FUTA tax of 0.6%, which means that the maximum FUTA tax per employee per year is \$42.00. States are required to have their state taxable wage base at a level that is at least the same or higher than the federal taxable wage base. States are also required to be in compliance with other federal requirements. To the extent that the federal government increases the federal taxable wage base above \$8,500, as has been discussed at the federal level, the General Assembly would have to increase the State taxable wage base and would likely have to make corresponding statutory adjustments to the tax tables.

As shown in **Exhibit 1**, the balance of the State’s UI trust fund has fluctuated over the years, growing in good economic times to over \$1 billion and diminishing in bad economic times to a level that required the UI trust fund to borrow \$133.8 million from the federal government in February 2010. Despite further infusion of \$126.8 million of federal modernization incentive funds in May 2010, with the repayment of the borrowed funds by December 2010, the balance of the UI trust fund remained at a level that required Maryland employers to pay from the highest tax table from 2010 through 2012. Due to the more favorable employment picture in the State and lower claims activity (resulting in a significantly increased balance of the UI trust fund), employers paid from Table C in calendar 2013 and have paid from either Table A or B since that time. The September 30, 2016, balance in the UI trust fund was approximately \$1.1 billion, meaning that employers will continue paying from Table A in calendar 2017. The Department of Legislative Services notes that the funding provisions in Chapter 337 of 2016 only apply to movements from a higher tax rate table to a lower tax rate table, and that, therefore, the Act had no effect on the determination for calendar 2017.

Exhibit 1
Maryland’s Unemployment Rate, UI Trust Fund Balance,
and Annual Benefit Payouts
Calendar 2006-2017

Calendar Year	Percentage Unemployment Rate at End of Year¹	UI Trust Fund Balance as of Prior September 30 (\$ in Millions)²	Tax Rate Table in Effect	Annual Benefit Payouts³ (\$ in Millions)
2006	3.8	\$883.1	B	\$383.5
2007	3.4	1,032.5	A	433.3
2008	5.8	1,057.8	A	633.5
2009	7.6	895.4	B	1,068.8
2010	7.4	301.7	F	900.7
2011	6.9	273.4	F	795.7
2012	6.8	460.2	F	778.5
2013	6.1	794.5	C	736.1
2014	5.5	954.7	A	667.0
2015	5.0	910.7	B	563.5
2016	4.3	983.7	A	415.6
2017	N/A	1,081.0	A	N/A

¹Data is from DOL: Unemployment rate as of December of each year, 2016 is as of August 2016.

²Data is from DLLR: Calendar 2010 includes \$133.8 million in borrowed funds (February 2010) and \$126.8 million in federal modernization funds (May 2010); borrowed funds were repaid in full by December 2010.

³Data is from DOL: 2016 payout amount is through September.

Note: The historic high unemployment rate for Maryland was 8.3% in August 1982, and the historical low was 3.3%, which has occurred several times.

Source: U.S. Department of Labor (DOL); Department of Labor, Licensing, and Regulation (DLLR)

Weekly Benefit Increase

Under Maryland law, weekly benefit amounts range from \$50 to \$430 per week, based on earnings in the base period. The history of maximum weekly benefit amounts is shown in **Exhibit 2**. Benefit amounts have been increased over time through legislation to keep a fairly steady wage replacement rate of between 42% and 46%. Maryland’s average weekly wage in the first quarter of 2016 was \$1,103, according to the U.S. Bureau of Labor Statistics. The current maximum weekly benefit of \$430 is 40% of this amount, having lost ground due to wage growth. Legislation introduced during the 2016 session that would have increased the maximum weekly benefit amount failed to pass.

Exhibit 2
Increases to Maximum Weekly Benefit Amount and Wage Replacement Rates

<u>Year of Increase</u>	<u>Maximum Weekly Benefit Amount</u>	<u>Average Weekly Wage of Prior Year*</u>	<u>Wage Replacement Rate</u>
2000	\$280	\$628	44.6%
2002	310	681	45.6%
2005	340	788	43.2%
2007	380	856	44.4%
2009	410	969	42.4%
2010	430	982	43.8%

*Excludes governmental employment.

Source: Department of Labor, Licensing, and Regulation

Joint Committee on Unemployment Insurance Oversight

The Joint Committee on Unemployment Insurance Oversight monitors laws and policies that affect the State UI system, including administrative and federal funding issues, and studies other potential legislative changes to UI benefits. The joint committee plans to hold a meeting during the 2017 legislative session to discuss the status of the UI trust fund and any legislation.

Business Regulation

Renewable Energy

Now in their eleventh year, the Renewable Energy Portfolio Standard requirements would have been increased under 2016 legislation that was vetoed. Utilities will need to work toward achieving ramped-up post-2015 electric energy efficiency goals. The Task Force on the Maryland Clean Energy Center is discussing how to make the center self-sustaining. Maryland has a Clean Generation Set-Aside Account that may be used by newly constructed qualifying efficient power plants. To ensure agricultural and land preservation, local governments want more say in the approval process for solar panel installations.

Renewable Energy Portfolio Standard

Maryland's Renewable Energy Portfolio Standard (REPS) requires that renewable sources generate specified percentages of Maryland's electricity supply each year, increasing to 20% by 2022, including 2% from solar energy. Maryland's REPS operates on a two-tiered system with corresponding renewable energy credits (REC) for each tier. Tier 1 includes preferred sources, with carve-outs for solar energy and offshore wind energy. Tier 2, which phases out after 2018, includes only large hydroelectric sources. For the 2014 compliance year, (the most recent for which data are available) electricity suppliers retired approximately 7.8 million RECs at a cost of \$104.0 million. Of that amount, Tier 1 nonsolar cost was \$70.6 million, Tier 1 solar cost was \$29.4 million, and Tier 2 cost was \$4.0 million. In 2017, the REPS requirements are 13.1% for Tier 1 renewable sources, including at least 1.15% from solar energy, and 2.5% from Tier 2 renewable sources. Electric companies (utilities) and other electricity suppliers must submit RECs equal to the percentage specified in statute each year or pay an alternative compliance payment (ACP) equivalent to their shortfall. The Maryland Energy Administration (MEA) must use ACPs to support new renewable energy sources.

Senate Bill 921/House Bill 1106 of 2016 would have increased the annual percentage requirements for Tier 1 sources from 20% by 2022 to 25% by 2020; however, the Governor vetoed the bills.

EmPower Maryland

In 2008, the General Assembly passed the EmPower Maryland Energy Efficiency Act, Chapter 131, which set target reductions of 15% in per-capita electricity consumption and peak demand, respectively, by 2015 from a 2007 baseline. By the end of 2015, the utilities had achieved 99% of their energy consumption goal and 100% of the peak demand goal. In January 2013, as required under the Act, MEA and the Public Service Commission (PSC) jointly submitted a report to the General Assembly in which MEA recommended that Maryland continue to set EmPower

goals beyond 2015 and laid out a planning framework and path forward to provide the information necessary to set these goals. In December 2014, PSC approved the utilities' proposals to continue the core EmPower programs into the next program cycle (2015-2017). Beginning in 2016, the utilities will work toward achieving newly established post-2015 electric energy efficiency goals designed to achieve an annual incremental gross energy savings equivalent to 2% of the individual utility's weather-normalized gross retail sales baseline, with a ramp-up rate of 0.20% per year.

Task Force on the Maryland Clean Energy Center

Chapter 577 of 2016 established the Task Force on the Maryland Clean Energy Center (MCEC) to determine how best to make MCEC self-sustaining without deviating from its mission and charge. The Department of Legislative Services, in consultation with the Department of Commerce, must provide staff for the task force. By December 1, 2016, the task force must report its findings and recommendations to the Governor and the General Assembly. At its first two meetings, the task force reviewed the structure and operations of several State financing instrumentalities: MCEC, the Maryland Economic Development Corporation, the Maryland Environmental Service, the Maryland Technology Development Corporation, the Maryland Health and Higher Educational Facilities Authority, and the Maryland Industrial Development Finance Authority, which is in the Department of Commerce. The task force plans to meet at least once more in November to discuss options and prepare for the completion of its report.

MCEC received no State funds when it was established in 2008. However, MCEC received grant funding from Montgomery County, from MEA as part of a federal grant, and from a private foundation. From fiscal 2009 to 2016, MCEC received loans from MEA. Most recently, MCEC will receive a grant from MEA to operate through fiscal 2017. While providing several programs and services, MCEC has been unable to fulfill its statutory mission, including implementing a green bank, without additional financial assistance.

Power Plant Development Funds

In 2007, Maryland joined the Regional Greenhouse Gas Initiative (RGGI), a cap-and-trade program established in conjunction with eight other Northeastern and Mid-Atlantic states. Each state limits carbon dioxide emissions from electric power plants, issues carbon dioxide allowances, and establishes participation in carbon dioxide allowance auctions. A single carbon dioxide allowance represents a limited authorization to emit one ton of carbon dioxide. Total allowances in the Maryland program are 19.4 million in 2016, which decreases over time to 17.8 million by 2020.

Generally, power plants must purchase carbon dioxide allowances equal to their carbon dioxide emissions. However, Maryland has a "Clean Generation Set-Aside Account," through which the Maryland Department of the Environment can award (not sell) up to 1.9 million

allowances each year to qualified power plants. To qualify, a power plant must (1) use gaseous fossil fuel as the primary fuel; (2) have applied the best available control technology or lowest achievable emissions rate, as applicable; and (3) not have been constructed under a PSC order or by agreement with the State. These allowances may not be resold by the recipient. These awarded allowances reduce the number of allowances available for purchase by other power plants and as such represent a forgone revenue stream for the State.

Siting of Solar Panels an Increasingly Contentious Issue

Solar capacity in the State continues to increase exponentially, starting from essentially nothing in 2006 and growing to nearly 600 megawatts as of October 2016. However, that growth – and the land necessary to accommodate it – can create conflict between the various affected stakeholders. For example, installing solar panels on farmland can lead to renewable energy advocates being at odds with agricultural and land preservation advocates over the use of historically agricultural land. The issue is further complicated by the State-centric power plant siting process, in which PSC can grant a certificate of public convenience and necessity (CPCN) for the installation of larger power plants. While local governments are allowed to comment during the proceedings, ultimately they cannot override a CPCN decision by PSC.

Business Regulation

Transportation Network Services

Legislation regulating transportation network services like Uber or Lyft was passed during the 2015 session with a broad stakeholder consensus. While the legislation has been implemented, three issues may warrant discussion during the 2017 session. The Public Service Commission is determining whether fingerprinting must be part of each transportation network company's process for complying with criminal history records check requirements. The Maryland Insurance Administration is studying the availability of insurance that meets the State's statutory requirements. In various parts of the country, there has been some consideration as to whether an employer-employee relationship exists between transportation network companies and transportation network operators.

Background

Uber Technologies, Inc., and other similar companies such as Lyft have upended the for-hire transportation business model over the past several years. These companies provide smart phone applications that use a smart phone's Global Positioning System to connect people who desire transportation services with nearby providers of transportation services in the company's network. Vehicle options offered across the current providers range from personal cars to taxis to sport utility vehicles. From its 2009 start in San Francisco, California, Uber had expanded to hundreds of cities worldwide by the end of 2014, and Lyft followed a similar expansion pattern in the United States. Uber and Lyft both began operating in Maryland in 2013.

Legislation Established a Regulatory Framework for Transportation Network Companies in 2015, Clarified in 2016

Chapter 204 of 2015 established a regulatory framework for "transportation network services" that encompasses "transportation network companies" and "transportation network operators." Chapters 16 and 28 of 2016 made several clarifying and technical changes to the law, particularly relating to the trip assessment process. Highlights of the statutory framework include:

- a license application and approval process for transportation network operators, including criminal history records checks;
- minimum motor vehicle insurance requirements, which require policies to cover the transportation network operator while the individual is providing transportation network

services, including liability, uninsured motorist, and personal injury protection coverages; and

- local governments that licensed or regulated taxicab services on or before January 1, 2015, either directly or through the Public Service Commission (PSC), may impose an assessment on trips that originate within the county or municipality – generally up to 25 cents per trip, subject to certain requirements.

Regulations and Studies

Chapter 204 required PSC to adopt regulations for the electronic processing of license applications and to ensure that transportation network companies and operators are making reasonable efforts to make transportation network services accessible to all people, including individuals with disabilities. The regulations became effective in March 2016.

The Comptroller was authorized to adopt regulations to carry out the provisions of Chapter 204 relating to the per-trip assessments authorized for certain local governments, including requirements and procedures regarding the administration, collection, and enforcement of the assessments. As of October 2016, no regulations have been proposed.

PSC was required to study the laws and regulations that apply to sedan, limousine, and taxicab services for purposes of modernizing and streamlining the application processes and other requirements and allowing these services to better compete in the marketplace. By December 1, 2015, PSC was required to submit an interim report, and by July 1, 2016, PSC was required to submit a final report with any findings and recommendations. The final report recommended a comprehensive overhaul of the regulation of taxicab services in Baltimore City and Baltimore County. Taxicab regulations are anticipated in late 2016 or early 2017.

The Maryland Insurance Administration (MIA) was required to conduct a study on (1) the availability of the insurance requirements specified in Chapter 204 for the transportation network industry offered by insurers admitted in the State; (2) the methods to increase the availability of the coverages by admitted carriers; and (3) the affordability of the coverages. Although due November 1, 2016, a report from MIA on its findings and recommendations was not yet available as of mid-November.

Criminal History Records Checks

Under current law, PSC may issue a permanent transportation network operator's license to an applicant on the submission of a satisfactory supplemental criminal background check, which requires fingerprints. However, prior to December 15, 2016, PSC may not require an applicant to comply with this provision if certain other conditions are met that satisfy the commission. Transportation network companies are also authorized to request a waiver from the provision. On

receipt of a waiver request, PSC must determine whether the transportation network company's process for complying with criminal history records check requirements can be shown to be as comprehensive and accurate as the supplemental criminal background checks. PSC must grant, deny, or approve an alternative to the waiver within three months after receiving the request. Uber and Lyft both requested a waiver on September 15, 2016, which requires PSC to make a determination by December 15, 2016.

Uber Drivers' Independent Contractor Status Challenged in California

A recent development in the ongoing evolution of the transportation services sector is the nature and extent of the employer-employee relationship between transportation network companies and transportation network operators. For example, in California, three Uber drivers filed a case in mid-2015 in U.S. District Court claiming they are employees of Uber, as opposed to independent contractors, and, thus, are eligible for various statutory protections for employees. In December 2015, the case became a class action lawsuit. A settlement was agreed to by the parties, but was subsequently rejected by the court in August 2016. It is unclear if another settlement will be reached or if the case will go to trial. Many other cases are currently being litigated throughout the country at various levels.

Self-driving Vehicles

Transportation network companies are at the forefront of the new self-driving vehicle technology. Uber has announced plans to eventually replace many of its one million drivers with self-driving vehicles, and in September 2016 it began a pilot program utilizing self-driving vehicles in Pittsburgh, Pennsylvania. Each vehicle has a safety driver in the front seat due to technical limitations; for example, the current technology has difficulty driving in inclement weather. Other transportation network companies, such as Lyft, have also expressed interest in replacing their drivers with self-driving vehicles.

Business Regulation

Employee Wages and Benefits

Employee wages and benefits, including overtime, paid sick leave, fair scheduling, and worker classification, continue to be discussed at all levels of government.

Background

Employment standards, practices, and benefits remain at the forefront of policy debates on the federal, State, and local levels. Workers' rights advocates continue to push for legislative changes to expand eligibility for overtime wages, require employers to provide paid sick leave, encourage flexibility and certainty in scheduling, and clarify worker classification standards, among other issues. During the 2016 session, the Maryland General Assembly considered legislation on or generally discussed overtime, paid sick leave, fair scheduling, and worker classification standards. Developments on the federal level and in other jurisdictions over the 2016 interim have sustained interest in these topics.

Federal Changes to Overtime Rule Exemptions

In spring 2014, President Barack Obama directed the Secretary of Labor to address overtime protections with the intent of increasing the overtime salary threshold and simplifying rules for employees and employers. Most "salaried" or "white collar" employees are exempted from federal overtime laws requiring that overtime be paid when an employee works over 40 hours per week. These "executive, administrative, and professional" employees must be paid for overtime only if their salary is below the threshold established by the U.S. Department of Labor (DOL) through regulations under the federal Fair Labor Standards Act (FLSA).

DOL is authorized to set various standards or tests which employees must meet to qualify for overtime exemptions. For an employee to be exempted from FLSA overtime requirements, the employee's income must exceed the threshold and the employee must meet every listed test guideline for the employment category. By raising the threshold, an employee whose weekly salary is lower than the threshold would no longer be exempted from the FLSA simply because the employee met specified test guidelines for the employment category. Additionally, highly compensated employees whose total annual compensation exceeds \$100,000 annually are specifically exempted under the FLSA; these employees are also exempted if they perform the already enumerated duties of exempt executive, administrative, or professional employees.

In July 2015, DOL announced its proposed overtime rule, anticipating that the salary thresholds would increase to the fortieth percentile of weekly earnings for full-time salaried workers and to the ninetieth percentile of weekly earnings for full-time, highly compensated salaried workers. DOL also proposed an annual adjustment for the two thresholds.

In May 2016, DOL published the final overtime rule, which will take effect on December 1, 2016. Under the rule, the salary threshold increases to the fortieth percentile of weekly earnings for full-time salaried workers in the lowest-wage U.S. census region, which is currently the South region, rather than all full-time salaried workers. Therefore, the threshold increases from a weekly salary of \$455, or \$23,660 annually, to a weekly salary of \$913, or \$47,476 annually. In addition, the threshold for highly compensated employees would increase to the ninetieth percentile of weekly earnings for full-time salaried workers nationally. The \$100,000 exemption for highly compensated employees increases to \$134,004 annually. DOL will further adjust the thresholds every three years beginning in 2020, based on DOL estimates of the fortieth percentile of full-time salaried workers in the lowest-wage census region.

To show the effect on employees of a \$47,476 threshold, **Exhibit 1** presents select salary data for the various professions.

Exhibit 1
Selected Professions' Median Pay and Number of Jobs for
Calendar 2015

<u>Profession</u>	<u>Median Annual Pay</u>	<u>Median Hourly Pay</u>	<u>Number of Jobs</u>
Claims Adjusters, Appraisers, Examiners, and Investigators	\$63,000	\$30.32	315,300
Financial Service Industry Employees	71,500	34.40	341,500
Nurses	67,400	32.45	2,751,000
Medical Equipment Repairers	46,300	22.23	48,000

Source: U.S. Bureau of Labor Statistics, Occupational Outlook Handbook

State and local governments are also covered by the FLSA, although state legislatures and their staffs are not; therefore, a change in the dollar threshold will likely affect State and local government expenditures. The Department of Legislative Services estimates that State personnel expenditures could increase by \$1.8 million in general and special funds in fiscal 2018 if each eligible employee works one extra hour per week. Information on the White House's web page estimates that 4.2 million workers in the United States – 3.2% of all workers covered by the FLSA – are affected by the new overtime rules. The web page contains state-by-state information and estimates that 79,630 Maryland workers could be affected by the overtime rule changes. DOL expects that employers may respond to the changes by increasing employee salaries to the new threshold, paying workers overtime for extra hours worked as required by the new rules, or limiting workers to 40 hours per week.

Paid Sick Leave

Neither federal nor State laws broadly require all private-sector employers to provide employees with paid or unpaid sick leave.

Legislation has been introduced in Maryland during the last few sessions to establish a paid sick leave requirement for specified employers. The 2016 version of the legislation would have required an employer to provide at least 56 hours (seven days) of paid or unpaid “sick and safe leave” at an accrual rate of 1 hour of leave for every 30 hours of work. Employers with 10 or more employees would have been required to provide paid leave, while employers with fewer than 10 employees would have been required to provide unpaid leave. Both types of leave were accrued in the same manner and each employee would have been entitled to take earned sick leave for themselves or for a family member’s illness. Subject to specified exemptions, the mandate would have applied to most employers, including State and local governments. An amended version of the legislation advanced through the House of Delegates, but failed in the Senate.

Although some jurisdictions have enacted ordinances that require employers to provide paid sick leave, California, Connecticut, Massachusetts, Oregon, and Vermont are the only states to do so. In June 2015, the Montgomery County Council passed legislation that authorizes employees who work for employers that have five or more employees effective October 1, 2016, to earn 1 hour of paid sick and safe time for every 30 hours worked, up to 56 hours annually. Employees of employers that have fewer than five employees will accrue up to 32 paid hours and 24 unpaid hours annually (for a full-time worker, 4 days of paid leave and 3 days of unpaid leave). Additionally, on October 14, 2015, the Planning, Zoning, and Economic Development Subcommittee of the Prince George’s County Council tabled legislation similar to the Montgomery County measure and instead passed a resolution urging the Prince George’s County Delegation to advocate for statewide paid sick leave legislation.

Fair Scheduling

The “just-in-time” method of scheduling shift workers has become a standard practice for many employers. As a result, workers are subjected to last-minute scheduling changes, unexpected or unwanted lengthened or shortened shifts, and days of being “on-call.” These policies require workers to remain flexible and ready to meet an employer’s last minute request. The cost to the worker, however, is that budgeting, scheduling, and honoring personal commitments remains difficult. The federal Schedules That Work Act and legislation introduced in many states and local jurisdictions seek to provide employees with more certainty and notice about scheduling changes.

During the 2016 legislative session in Maryland, one piece of legislation attempted to address employee scheduling: the Fair Scheduling, Wages, and Benefits Act (Senate Bill 664/House Bill 1175). The act would have required an employer to provide each employee with an initial work schedule at least 21 days before the first day the employee was

scheduled to work, notify an employee of any subsequent changes to the initial work schedule, and within 24 hours after making a change to an employee's work schedule, provide the employee with a revised work schedule. An employer that changed an employee's work schedule under specified circumstances would have been required to pay the employee one hour of predictability pay. An employer would have also been required to offer additional hours of work to current employees before hiring new employees or subcontractors. Generally, employees who held jobs that required substantially equal skill, effort, responsibility, and duties and were performed under similar working conditions, would have been required to be paid the same hourly wage, have the same eligibility to accrue employer-provided paid and unpaid leave, and be provided the same promotion opportunities and other conditions of employment.

Although employee scheduling legislation has been introduced in many jurisdictions, Vermont is the only state to have employee scheduling protections in place.

Worker Classification

As businesses embrace new technology, they have adjusted their practices to interact with their customers and workforce in new platforms. Through serving as a matchmaker to put workers who are willing to provide services in touch with customers who are looking to receive services, ride sharing companies like Uber have established business models that are predicated on flexibility and independent contractors. Workers' rights advocates contend that the shift toward flexibility has led to the erosion of the traditional employment relationship, which carries with it important benefits for workers. As a result, litigation and administrative proceedings for worker benefits been filed in several states to classify workers, such as Uber drivers, as employees.

Regulatory agencies in some states have recently classified workers as employees for purposes of unemployment benefits. For example, the New York State Department of Labor spent months – instead of weeks, which is more typical – reviewing two former Uber drivers' applications for unemployment benefits before ultimately awarding the benefits to the drivers. During the same period of time, the agency denied unemployment benefits to four other drivers. Similar proceedings have taken place in California and Florida, where some Uber drivers have received favorable unemployment benefit determinations and other drivers have been denied unemployment benefits. The decisions are made on a case-by-case basis and do not affect benefit determinations in other contexts.

Business Regulation

Regulation of Short-term Residential Rentals

A new type of housing rentals has emerged in the so-called sharing economy. Hotels, motels, and bed and breakfast establishments are generally regulated at the local level. Local governments are considering how to regulate short-term residential rentals, including licensing and tax requirements. It is unclear how anti-discrimination laws are applied to these rentals.

Short-term Residential Rentals

Short-term residential rentals (STRR) are a fairly new and ever-growing type of operation in the so-called sharing economy. In these transactions, an owner of residential property rents use of a portion or all of the property for short periods of time via an online platform/marketplace, which charges the “guest” a fee per rental. Some of the more popular online platforms include Airbnb, Flipkey, Homeway, and VRBO. Traditionally, local laws allow homeowners to exercise their property rights by renting a portion or all of their home for 30 consecutive days or more at a time, in conformance with local zoning or other requirements. A home rental for less than 30 consecutive days, such as for visitors to a special local event or as an alternative travel accommodation, is the type of rental that has become an issue in recent years for many areas, including cities and vacation destinations.

While the difference between a STRR and a hotel is more obvious, the difference with a bed and breakfast (B&B) is less so. Generally, a STRR property is rented for a short period of time, retains its residential character, and is intended to provide supplemental income to the property owner. A STRR may be located in a single-family home or a unit in a condominium, and may be the whole dwelling or a single room or space (such as a couch) in the dwelling. A B&B is a commercial lodging property in operation year-round, usually located in a single-family home, and is subject to the same local regulation as a hotel. Regulation may include registration; licensing and inspections for food safety and building code compliance; and zoning requirements. Many jurisdictions have no tax or regulatory laws regarding STRRs. Other jurisdictions have laws including registration; licensing; inspections; and zoning requirements.

Advocates for STRRs argue that local areas gain from the boost in tourism. Renters prefer the rates, usually half those of hotels or less, and homeowners maintain that they are simply exercising their property rights in a new way and appreciate or depend on the extra income. On the other hand, property owners near STRRs and neighborhood groups increasingly want more regulation of the rentals or even outright bans. They complain that STRRs bring noise, traffic, and a steady stream of unknown people into their everyday lives, and lower property values. Furthermore, some opponents argue that owners of short-term rentals may be in violation of the bylaws of the common ownership community in which they may be located or the terms of any mortgage or homeowners insurance policy for the property, as well as any local zoning, fire, and

occupancy codes. Other critics say STRRs displace lower-income families by reducing the stock of affordable housing. The American Hotel and Lodging Association maintains that many STRR hosts are not simply homeowners seeking the occasional extra dollar but are rather business entrepreneurs, often owning and renting several STRRs at one time with little oversight, who should be subject to the same regulation as hotels and other forms of commercial lodging. This association argues that there should be a level playing field throughout the commercial lodging industry, including this newest business model.

Regulation of Short-term Residential Rentals in Maryland and in Other States

There is no statewide regulation of STRRs in Maryland. At the local level, only a small number of jurisdictions regulate STRRs, primarily through licensing. According to the Maryland Municipal League (MML), most municipalities do not regulate STRRs. However, the following municipalities do impose a licensing requirement of some kind: Annapolis; Bowie; Easton; and Ocean City. MML reports that no municipalities have addressed this issue of enforcing tax collection. According to the Maryland Association of Counties (MACo), most counties do not have regulatory schemes that specifically address STRRs. Baltimore, Anne Arundel, and Prince George's counties seem particularly eager to address the local tax collection issue, while Baltimore City is currently considering legislation to apply the city's existing hotel tax to the online platforms that facilitate the use of a STRR. MACo reports that Montgomery County is considering legislation to regulate STRRs by amending both their local zoning ordinances and transient housing licensing requirements. Pending this consideration, Montgomery County passed expedited legislation in 2015 to require online platforms to pay the same tax required of hotels.

Various large and small cities throughout the country regulate STRRs. According to the Short Term Rental Advocacy Center in terms of statewide laws, Florida enacted a measure in 2011 that prohibits a local government from passing any new law that bans STRRs. This law was amended in 2014 to allow some limited regulation by cities. Arizona enacted a similar statewide ban earlier this year, and while the New York legislature also passed a similar statewide ban, the measure has not yet been signed into law.

State Tax Requirements of Short-term Residential Rentals

The rental of a house or a room in a hotel, motel, bed and breakfast, or house is generally subject to the State sales and use tax and a county hotel rental tax. A limited number of municipalities also impose a hotel rental tax. A municipal hotel rental tax applies in a similar manner to the county hotel rental tax for the county in which the municipality is located. A house or room rented in a house through an online marketplace is generally subject to the State sales and use tax. Under a county hotel rental tax, the particular definition of hotel and the language applying the tax will impact the taxability of a transaction completed through an online marketplace.

The 6% State sales and use tax is imposed on an accommodation, defined as a right to occupy a room or lodging as a transient guest. A room in a hotel, motel, B&B, or house offered for rent satisfies this definition for State sales and use tax purposes. Airbnb is a STRR that allows people to list and find houses or rooms for rent. It is likely that the Comptroller will consider an online marketplace such as Airbnb that facilitates the sale or use of a house or room to be an intermediary. As an accommodations intermediary, Airbnb is required to collect and remit the State sales and use tax on the full amount of the consideration paid by a buyer for the sale or use of an accommodation. The Comptroller's Office requires an entity or individual that rents a home or part of a home as a transient accommodation to remit the State sales and use tax. The Comptroller's Office advises that entities that advertise or otherwise make known to the public that transient accommodations are available to rent, are more easily identifiable than individual homeowners providing such accommodations.

Each county has the authority to impose a hotel rental tax with rates ranging from 3.0% to 9.5%. The authority to impose the hotel rental tax varies depending on how the authority is granted. There are two variations in county hotel rental tax laws that may impact the application of the tax to a transaction made through an online marketplace like Airbnb. A transaction through Airbnb may be excluded either because the facility does not meet the definition of hotel or the hotel rental tax provisions exclude the type of transaction.

The individual or entity required to collect the hotel rental tax and the charge on which the tax is paid vary by county. In the majority of the counties, Airbnb does not meet the statutory definition of a hotel and is, therefore, not required to collect the tax. If an online marketplace is not required to collect the hotel rental tax, the establishment offering the rental may still be required to collect and remit the hotel rental tax. Five counties and Baltimore City have adopted provisions addressing the issue of intermediary sales through online marketplaces (Anne Arundel, Baltimore, Harford, Howard, and Montgomery).

Applicability of Anti-discrimination Laws on Short-term Residential Rentals

State and federal law prohibit discrimination in “places of public accommodation.” This prohibition extends, subject to certain exceptions, to any establishment that provides lodging to transient guests. These laws clearly apply to hotels, motels, and most B&Bs. However, it is less clear how these and other anti-discrimination laws apply to a STRR.

Title II of the Civil Rights Act of 1964 provides, “All persons shall be entitled to the full and equal enjoyment of the goods, services, facilities, privileges, advantages, and accommodations of any place of public accommodation [...] without discrimination or segregation on the ground of race, color, religion, or national origin.” The law defines a place of public accommodation to include “any inn, hotel, motel, or other establishment which provides lodging to transient guests [...]” However, the public accommodation law also includes an exemption (sometimes called the “Mrs. Murphy exemption”) for establishments “located within a building which contains not more than five rooms for rent or hire and which is actually occupied by the proprietor of such establishment as his residence.” Maryland's public accommodation law closely mirrors the

federal act, although it covers a broader protected class. The definition of a place of public accommodation and a Mrs. Murphy exemption in State law are similar to federal law.

Courts have not yet addressed whether public accommodation laws apply to STRRs. It is likely that owners of these rentals fall under the Mrs. Murphy exemptions. However, the situation becomes less clear when the rental is a vacation house or investment property that the owner only visits occasionally. Some legal scholars argue that these businesses should themselves be treated as places of public accommodation, because they serve many of the same functions as hotels or motels. In May 2016, plaintiffs filed a class action suit against Airbnb in U.S. District Court for the District of Columbia based, in part, on this theory. The complaint alleges that “Airbnb is an inn, hotel, motel, or other establishment which provides lodging to transient guests,” and that it violated the federal act by denying African American plaintiffs full and equal enjoyment of the goods and services, facilities, privileges, advantages, and accommodations offered by Airbnb.

Several other anti-discrimination laws are potentially relevant to STRRs. The federal civil rights statute prohibits race discrimination in contracting. However, in order to prevail in an action, a plaintiff must show not only that he or she was treated differently because of his or her race, but also that the defendant intended to treat him or her differently. Such intentional discrimination can be nearly impossible to prove, particularly in the case of a one-time interaction over the Internet. Because STRRs are used as short-term housing, they may also be subject to State and federal fair housing laws which prohibit discrimination in the sale or rental of “dwellings” – generally any place of residence meant to last more than a few weeks. The federal Fair Housing Act (42 U.S.C. §§ 3601 – 3619) prohibits a person from refusing to “sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.” State law contains nearly identical language, but covers a broader protected class. State and federal fair housing laws also contain Mrs. Murphy exemptions. However, the fair housing exemptions are much narrower and generally do not apply to race discrimination.

Public Safety

Police Surveillance, Tracking, and Privacy Issues

The law often fails to keep up with rapidly changing technological advances. Devices such as cell site simulators, high tech digital cameras, unmanned aerial vehicles, and the ability to store large amounts of data make it easier to track and apprehend suspected criminals. However, nondisclosure agreements governing their purchase and a lack of transparency regarding their use may circumvent State and federal laws intended to ensure compliance with standards of due process and privacy rights.

Background

Advances in investigational technology used by law enforcement agencies have prompted questions regarding the tracking of criminal suspects. Recently, discussion has focused on law enforcement's use of cell site simulators that effectively turn cell phones into real-time tracking devices and video monitoring of large geographic areas by air over long periods of time. Much of the controversy regarding such technologies has centered on (1) the scope of information gathered and the legal requirements for use of the technologies as they relate to an individual's Fourth Amendment right to privacy and (2) the lack of transparency in acquiring and deploying the technologies.

The Fourth Amendment to the U.S. Constitution protects individuals from unreasonable searches and seizures by the government and has been interpreted to create a right of privacy. The reasonableness of a governmental search often depends on the reasonableness of the expectation of privacy on the part of the person subject to the search, the location of the search, and the breadth of information gathered.

Generally, U.S. Supreme Court decisions have held a warrantless search of an individual's home to be unreasonable, with certain clearly delineated exceptions. However, courts have also held that the Fourth Amendment does not protect individuals from searches that take place in "open fields" because it is unreasonable for a person to have an expectation of privacy over activities that take place in such areas. Technological advances have made traditional legal standards that were often location-based difficult to apply, and courts and lawmakers have increasingly had to grapple with the threshold question of whether information gathered through emerging technology constitutes a search at all.

Cell Site Simulators

“Cell site simulators” or “IMSI catchers,” often referred to by their trade names of StingRay or Hailstorm, are cell phone surveillance devices that mimic cell phone towers and send out signals to prompt cell phones in the area to transmit location and other identifying information. When used to track a suspect’s cell phone, cell site simulators also compel information from all cell phones that happen to be nearby.

According to the American Civil Liberties Union (ACLU), 68 law enforcement agencies in 23 states and the District of Columbia currently use cell site simulator technology. In Maryland, the ACLU indicates that Anne Arundel, Baltimore, Harford, Howard, Montgomery, and Prince George’s counties, the Baltimore City Police Department (BPD), and the Department of State Police have the technology. Determining which law enforcement agencies are deploying cell site simulator technology has been hindered by nondisclosure agreements with the Federal Bureau of Investigation and Harris Corporation, the manufacturer of the device, entered into as a condition of sale of the devices. As revealed by court documents, BPD’s nondisclosure agreement precluded disclosure of any information related to the cell site simulator technology, even in court documents or during judicial hearings.

Recent Legislation

Chapter 191 of 2014 authorizes a court to issue an order authorizing or directing a law enforcement officer to obtain “location information” from an “electronic device.” Location information means real-time or present information concerning the geographic location of an electronic device that is generated by or derived from the operation of that device. A court may issue an order by application on a determination that there is probable cause to believe that (1) a misdemeanor or felony has been, is being, or will be committed by the user/owner of the electronic device or the individual about whom electronic location information is being sought and (2) the location information being sought is evidence of, or will lead to evidence of, the misdemeanor or felony being investigated or will lead to the apprehension of an individual for whom an arrest warrant has previously been issued.

House Bill 904 of 2016 sought to add a detailed definition of “cell site simulator device”; specific requirements relating to applications, orders, and required law enforcement actions; exclusionary penalty provisions; and reporting requirements. House Bill 257 of 2016 sought to expand the definition of “location information” to include historical information. Neither bill passed, but it is expected that similar measures may be pursued in the 2017 session.

Case Law

As of this writing, the U.S. Supreme Court has declined to hear a case addressing the use of cell site simulators. However, in March 2016, the Maryland Court of Special Appeals addressed the issue in *State v. Andrews*, 227 Md. App. 350. Kerron Andrews was arrested by BPD in May 2014. The department had acquired a Pen Register and Trap and Trace Order compelling his

service provider to provide police with the general GPS coordinates of his mobile phone. Without acquiring an additional warrant to use the technology, BPD officers were able to isolate the specific residence in which Andrews was located using a cell site simulator, after which they obtained a warrant to enter and search the residence where they arrested Andrews and located a firearm.

In upholding the circuit court's suppression of evidence found at the residence, the Court of Special Appeals held, among other things, that the use of the cell site simulator constitutes a search for the purposes of the Fourth Amendment and that individuals have a reasonable expectation that their mobile devices will not be used to provide real-time tracking information to the police. Therefore, the use of a cell site simulator requires a valid search warrant, or an order satisfying the constitutional requisites of a warrant, unless an established exception to the warrant requirement applies. The court also clarified that the current Pen Register and Trap and Trace statute is not applicable to cell site simulators.

The facts underlying the *Andrews* case occurred before Chapter 191 of 2014 took effect. The *Andrews* opinion specifically declined to address the application of Chapter 191 or to opine as to whether an order under the provisions of Chapter 191 will suffice to satisfy the requirements of a warrant based on probable cause.

FCC Complaint

In addition to court action, several civil rights groups filed a complaint with the Federal Communications Commission (FCC) in August 2016 alleging that the reportedly prolific use of cell site simulators by BPD interferes with emergency calls by all phones in an affected area and that BPD deploys the technology in a way that is racially discriminatory in that the disruptions disproportionately affect African American communities. The FCC has authority to regulate radio, television, wire, satellite, and cable communications and is tasked with protecting cellular networks from disruption and ensuring that emergency calls are unimpeded. The FCC must also ensure that access to networks is available "to all people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex." As of this writing, there have been no proceedings by the FCC on this complaint.

Aerial Surveillance

On August 26, 2016, Bloomberg Businessweek revealed that BPD, with funding from a private donor, had authorized the firm Persistent Surveillance to conduct aerial surveillance of a large portion of Baltimore City. Persistent Surveillance utilizes an array of wide-angle cameras mounted to a small Cessna airplane to monitor an area of roughly 30 square miles and continuously transmit real-time images to analysts on the ground. The footage is then stored and archived on hard drives for review later if necessary. According to reports, the program began in early 2016.

Public concern over the program and the lack of notice provided to the public has been compounded by revelations that the Baltimore City Council, Mayor Stephanie Rawlings-Blake, and many other city and State leaders were not made aware of BPD's activity until many months after the program began. As with cell site simulators, a main concern regarding the technology is the breadth of what is captured. Rather than just focusing on suspects, the outdoor activity of every citizen in a 30-mile radius is recorded and stored.

Persistent Surveillance and other proponents of the technology claim that, as currently designed, very little detail is captured by the cameras. Individuals appear as little more than a pixel and cannot be personally identified because of the low quality of the images. Opponents and privacy experts point out that, in a competitive market, it may only be a matter of time until highly detailed, high resolution, real-time aerial surveillance becomes a reality. What information may be stored and for how long also remains an open question.

Juvenile Shackling

Shackling and strip searching of youth within the juvenile justice system was an issue of concern during the 2016 legislative session, which resulted in the creation of the Task Force to Study the Restraint, Searches, and Needs of Children in the Juvenile Justice System. The task force has met to consider a number of issues and will likely have recommendations for legislation during the 2017 legislative session.

Background

The State's Juvenile Justice Monitoring Unit (JJMU) has, on multiple occasions, drawn attention to the policies and practices of the Department of Juvenile Services (DJS) regarding the indiscriminate shackling and strip searching of youth within the juvenile justice system. In its *Fourth Quarter Report and 2015 Annual Review*, the JJMU quotes the Maryland Judiciary in noting that shackling "can be traumatizing and contrary to the developmentally appropriate approach to juvenile justice." During the 2016 session, the General Assembly also expressed concern about the department's current policy of shackling children in certain facilities during transportation to and from court hearings, medical and educational appointments, and earned home passes, without any individualized determination of risk. Additionally, the legislature and JJMU have been deeply troubled by the department's policy of routinely strip searching children, regardless of whether there is an individualized or reasonable suspicion that they are concealing something potentially harmful. These concerns resulted in the addition of restrictive language in the fiscal 2017 budget withholding \$1.0 million from the department pending receipt of a report on the issue and the enactment of Chapter 655 of 2016 establishing the Task Force to Study the Restraint, Searches, and Needs of Children in the Juvenile Justice System.

Current Policies

Shackling

DJS policy requires mechanical restraints to be used at all times to transport a youth who has been placed in either a secure detention or hardware secure committed facility, regardless of the reason for transport. Youth placed in staff secure committed facilities are transported with the use of mechanical restraints for the first 30 days of placement. After 30 days, unless the youth poses a safety, security, or escape risk, transport is nonsecure. All secure transports are completed through the department's Transportation Unit by staff designated as transportation officers, who are required to complete specific training on a regular basis related to secure transports. Youth in community-based placements do not require the use of mechanical restraints during transport.

For individuals known to be pregnant, current departmental policies and procedures prohibit the use of waist chains, leg irons, or anything other than handcuffs during all trimesters of pregnancy and do not allow for the use of any mechanical restraint during the third trimester. Additionally, two staff are assigned to escort pregnant youth. As of July 2016, mechanical restraints are also prohibited from use on any youth during emergency-related medical transports. In addition, a court resolution issued on September 21, 2015, presumes that mechanical restraints should not be used on youth inside a courtroom unless the presiding judge or magistrate expressly orders the restraints to be reapplied.

DJS policy does allow for the use of mechanical restraints on youth residing in DJS facilities; however, staff are prohibited from using crisis prevention management techniques, including restraint or seclusion, as a means of punishment, sanction, infliction of pain or harm, demonstration of authority, or enforcing compliance with directions. Restraints, whether physical or mechanical, are to be used as a last resort to protect or prevent injury to self and others, or to prevent overt attempts at escape. The use of restraints is only permitted when all other interventions have been exhausted and must be documented and recorded. In addition, on-site health and behavioral health care staff must be notified.

Strip Searches

Visual body searches, which currently involve a youth being entirely undressed, are conducted at all DJS facilities whenever a youth is admitted to a facility after being off-grounds and after visitation, including visits with family members or legal counsel. Searches must be conducted by two staff that are the same gender as the youth in an area that ensures privacy. DJS staff are not permitted to touch youth during the visual body searches. If contraband is detected, the youth is taken to the local hospital.

According to DJS, the introduction of contraband can jeopardize the safety of youth and staff, and also risks the creation of an underground economy within the institution and potentially undermines any drug treatment programming. Therefore, unlike the department's policies regarding the use of mechanical restraints that target youth who pose the highest risk, the policies for employing visual body searches apply to all youth, as the security level or risk level assigned to a youth is not indicative of the potential for concealing contraband.

Interim Progress

The department's response to the restrictive language in the fiscal 2017 budget bill was submitted in July 2016 and was found to be substantially compliant with the request for information; however, DJS was unable to provide the requested data regarding the frequency or age range of youth who are strip searched or mechanically restrained during transport. This data is not currently collected, as it occurs as a matter of policy and procedure. This poses a concern, as the lack of data seriously hampers the ability to evaluate the magnitude of the issue, whether current policies are being applied indiscriminately, or even whether DJS is complying with its

existing policies. As such, the budget committees opted to grant only a partial release of the withheld funds and again requested that DJS gather and report the requested data before any further release of funds is considered.

The Task Force to Study the Restraint, Searches, and Needs of Children in the Juvenile Justice System began meeting in September 2016, with meetings occurring every two weeks. Discussion topics at the meetings have included a review of current DJS policies and procedures for shackling and strip searching youth, reviews of policies in other states, and expert presentations on the impact that shackling and strip searches may have on youth. At the time of this writing, the task force has considered potential recommendations put forth by multiple stakeholders, including DJS, JJMU and the Office of the Public Defender. A final report is anticipated by December 31, 2016, and legislation implementing the recommendations of the task force is likely to be introduced during the 2017 session.

Potential Recommendations

Based on discussions occurring during the task force meetings, potential recommendations could include the following:

Shackling

- Allow for individualized determinations for shackling based on a youth's identified risk level or other established criteria and input from facility staff.
- Ensure that adequate staff and resources are available to provide a nonsecure transport option to and from all facilities operated and utilized by DJS.
- Consider limiting the use of shackles based on the duration of the trip, as measured by either time or distance.

Strip Searches

- Increase the utilization of less invasive search practices, such as a wand or pat-down search, as the default procedure for contraband searches. Strip searches would be used as a last resort in instances where there is a properly documented case of reasonable suspicion and other attempts to recover contraband have failed.
- Modify existing strip search procedures so that the most comprehensive level of search involves less invasive alternatives, such as allowing youth to wear a smock or remain in their underwear during the search.

- Install cameras in the visitation areas with pan and zoom features to eliminate the need to conduct strip searches on youth following public visitation, unless there is a specific and documented instance of reasonable suspicion.
- Prohibit strip searches of youth following admission back into a DJS facility when the youth has been accompanied by and in the custody of DJS staff for the entire duration of time spent off-grounds.
- Prohibit strip searches of youth following meetings with legal counsel unless there is a reasonable suspicion of contraband.

Age Limit on Detention

- Prohibit youth under a certain age from being detained in a DJS detention facility or placed in an out-of-home treatment program.

Autonomous Vehicles

The U.S. Department of Transportation has issued federal guidelines concerning driverless, or autonomous, vehicles. The Maryland Department of Transportation has formed a working group with relevant stakeholders to begin discussions on the issues surrounding these vehicles. Proposals to establish a legislative task force to study issues related to the use of autonomous vehicles have been unsuccessful.

Background

According to news reports, automakers and technology companies are furiously competing to design and put on the road driverless, or autonomous, cars within the next 5 to 20 years. Nineteen companies, including Google, Audi, Uber, Tesla, Mercedes-Benz, and Nissan, promise to have cars with some level of autonomous ability within a few years. Experts suggest that it is only a matter of time before vehicles will do most if not all of the driving, independently from passengers. In fact, Morgan Stanley has predicted that by 2025 every car on the road in the United States will be autonomous.

Widespread use of autonomous vehicles holds the potential to increase public safety by reducing vehicle crashes. In its 2015 National Motor Vehicle Crash Causation Survey, the National Highway Traffic Safety Administration (NHTSA) assigned driver error as the “critical reason” for approximately 94% of reported automobile crashes. Experts point out that computer drivers would, in principle, be fundamentally safer drivers, since they allow no distractions, do not fall asleep or drink too much, are designed to have 360-degree vision and faster reaction times, and can accumulate knowledge from and communicate with thousands of other like vehicles.

A reduction in motor vehicle crashes would also mean a reduction in the economic and societal costs of vehicle crashes. In a study released in 2015, NHTSA estimated that the economic cost of motor vehicle crashes in 2010 was \$242 billion. When societal harms were taken into account, the total cost increased to \$836 billion. This estimate included productivity losses, property damage, medical and rehabilitation costs, legal and court costs, emergency services, insurance administration costs, costs to employers, and lost quality of life.

Efforts to improve road safety took on added urgency this year when it was reported that traffic fatalities rose dramatically in 2015. The 35,092 deaths represented a 7.2% increase over 2014. In addition, traffic deaths rose by 10.4% in the first half of 2016 over the first half of 2015. Increasingly, traffic safety experts are looking to autonomous vehicles as a means to improve highway safety and reduce fatalities.

States Begin to Respond

In 2011, Nevada became the first state to enact legislation authorizing the use of autonomous vehicles, and it issued its first license to Google in May 2012. As of August 2016, 6 other states (California, Florida, Michigan, North Dakota, Tennessee, and Utah) and the District of Columbia have enacted legislation related to autonomous vehicles. Legislation was introduced in 16 states in 2015, according to the National Conference of State Legislatures (NCSL), although only two bills were signed into law. According to NCSL, several issues that states are considering to accommodate the use of self-driving vehicles include liability, appropriate levels of insurance, cyber security, and the application of distracted driving laws to the individual who engages a self-driving vehicle.

In September, Pittsburgh became the world's first city to let a passenger hail an autonomous vehicle. Uber's ability to experiment on the streets of the city has been credited to what officials call "greenlight governing"; driverless vehicles are allowed because Pennsylvania's transportation rules do not explicitly ban them. According to the Pennsylvania Department of Transportation, as long as there is a licensed driver in the driver's seat operating the vehicle there is no current legal requirement that the human operator touch the steering wheel. This lack of regulation may not last. Pennsylvania has established a task force to provide guidance for the development of self-driving car policies. Pennsylvania lawmakers have already filed at least two bills related to testing and operation of driverless vehicles.

New Federal Guidelines

In September, the U.S. Department of Transportation (USDOT) issued a long-awaited policy paper detailing 15 points it expects automakers to comply with in their efforts to put autonomous cars on the road. The guidelines (not yet issued as regulations) urge automakers and technology companies to prove that their semiautonomous and autonomous vehicles can meet a list of safety expectations before they take the road. These include asking manufacturers to document for NHTSA how and where they expect their vehicles to operate, how the vehicles will interact with other cars and the roadway, how they validate their testing, how they intend to protect privacy and prevent hacking, and how they would share data collected by onboard computers. Also under the guidelines, the vehicles will be expected to follow various state and local laws and practices that apply to drivers. Any company developing autonomous vehicles is being asked to sign the 15-point safety checklist to "pre-certify" their vehicles.

In its 114-page guidelines, USDOT made clear that it thinks the federal government should take the lead in regulating the design and manufacture of automated vehicles. A critical piece of the federal guidance is aimed at keeping states from creating a patchwork of laws that might be at odds with other states. NHTSA views its role as overseeing automobiles, while state agencies supervise drivers. Self-driving vehicles, in which the automobile acts as both car and driver, potentially present a gray area. As motor vehicle equipment increasingly performs "driving" tasks, USDOT's exercise of its authority and responsibility to regulate the safety of such equipment

(e.g., hardware and software performing part or all of the driving task) is expected to increasingly encompass tasks similar to “licensing” of the non-human “driver.”

Legal Issues

Who will be responsible when something goes wrong with an autonomous vehicle and to what extent? Current liability laws provide some guidance, according to legal analysts. In the case of a crash that injures or kills someone, the parties would be likely to sue one another, but ultimately the car’s manufacturer, like Google or BMW, would probably be held responsible, at least for civil penalties. Product liability law, which holds manufacturers responsible for faulty products, may be applied to these new technologies. Manufacturers may, however, prefer the use of ordinary negligence laws, rather than design-defect laws, which are more expensive to litigate and can lead to costly recalls. Using ordinary negligence law, the computer “driver” would be held liable only if a human driver who took the same actions in the same circumstances would be held liable. Criminal penalties, on the other hand, may be difficult to apply, since robots cannot be charged with a crime. The courts ultimately will have a hand in providing answers as legal questions arise, based on the definitions and requirements set forth by lawmakers and regulators.

Maryland Developments

In December 2015, the Maryland Department of Transportation (MDOT) formed an Autonomous Vehicle Working Group to begin discussions with relevant stakeholders on the issues surrounding autonomous vehicles. According to MDOT, the working group includes representatives from throughout MDOT, including the Office of Planning and Capital Programming, the State Highway Administration, the Maryland Transportation Authority, and the Motor Vehicle Administration, as well as key stakeholders in other Executive Branch agencies, local government representatives, and other nongovernmental stakeholders such as automobile manufacturers and user groups such as the American Automobile Association and the Maryland Motor Truck Association.

Proposals in the General Assembly over the last three sessions to establish a legislative task force to study issues related to the use of self-driving vehicles have not been successful. The publication of the federal guidelines and calls by the federal government for states to form workgroups on these issues may help move such legislation. At a minimum, a bill to expressly authorize the Motor Vehicle Administration to adopt regulations governing the inspection, registration, and safe testing and operation of autonomous and connected vehicles and the safe testing and operation of autonomous technologies on the highways of the State may be considered in the upcoming session.

Drunk Driving and Ignition Interlock System Program

Legislation recently took effect that requires a person who is convicted the first time of driving under the influence of alcohol to install and use an ignition interlock device on the person's vehicle for at least six months. However, the law does not apply to any driver who receives a probation before judgment disposition.

Ignition Interlock Required for First Conviction

Upon conviction for a first offense of driving under the influence of alcohol or under the influence of alcohol *per se* (i.e., driving with a blood alcohol content (BAC) of 0.08 or higher), the offender's driver's license is assessed 12 points and is subject to revocation by the Motor Vehicle Administration (MVA). Chapter 512 of 2016 (Noah's Law) requires that a person convicted for the first time of driving while under the influence of alcohol or under the influence of alcohol *per se* participate for at least six months in the Ignition Interlock System Program (IISP) administered by MVA.

Probation before Judgment

Under Maryland law, a defendant may receive a disposition of probation before judgment (PBJ) instead of a conviction when the defendant pleads guilty or is found guilty of a crime. The court may stay the guilty judgment, defer further proceedings, and place the defendant on probation subject to reasonable conditions. If the defendant successfully completes probation, then the court must discharge the defendant from probation without a judgment of conviction.

A court may decide to issue a PBJ to a defendant for a first offense of driving under the influence or driving under the influence *per se*. While the court may order a defendant who is granted a disposition of PBJ to participate in IISP, there is no requirement that the court issue such an order. Because a PBJ disposition is not considered a conviction, a defendant is not subject to the imposition of an IISP requirement by MVA under Noah's Law.

However, even in the absence of a conviction, a defendant who refuses to take a test to determine the defendant's BAC or takes a test that results in a BAC of 0.15 or higher is subject to an ignition interlock requirement by MVA as a condition of modification of the lengthy license suspension required to be imposed.

Other States

Every state has an ignition interlock law that authorizes or requires the use of ignition interlock devices under specified circumstances. Twenty-four states, including Maryland, have a mandatory requirement for participation in an ignition interlock program after being convicted of a first offense related to driving under the influence of alcohol with a BAC of 0.08 or more. Of the 24 states that have a mandatory requirement for ignition interlock, only 8 have a formal program of deferred prosecution or other diversionary process that would allow a first time offender to avoid the requirement of an ignition interlock. The form and function of deferred prosecution programs vary widely among the states. For example, in some states, diversion programs are handled only at the local level. **Exhibit 1** shows the states that have mandatory interlock requirements and whether the state has a program that allows a defendant to avoid the imposition of an ignition interlock requirement.

Exhibit 1
States with Mandatory Ignition Interlock Laws

<u>State</u>	<u>Diversion Program</u>
Alabama ¹	Yes
Alaska	No
Arizona	No
Arkansas	No
Colorado	Yes
Connecticut	Yes
Delaware	Yes
Hawaii	No
Illinois	Yes
Kansas	No
Louisiana	No
Maryland	Yes
Mississippi	No
Nebraska	No
New Hampshire	Unknown
New Mexico	No
New York	No
Oregon	No
Tennessee	Yes
Texas	Yes
Utah	No
Virginia	No
Washington	No
West Virginia	Yes

¹Only if BAC results are \leq .15

Source: Department of Legislative Services

U.S. Department of Justice Report on Baltimore Police Department

In the wake of the death of Freddie Gray and the civil unrest that followed, the U.S. Department of Justice conducted an investigation of the Baltimore Police Department. The investigation found that the department engages in a practice or pattern of constitutional violations and that those violations disproportionately affect the city's African American citizens. The investigation also identified systemic deficiencies in policies, training, supervision, and accountability structures.

Background

Following the death of Freddie Gray while in police custody and the subsequent civil unrest, the leadership of Baltimore City requested that the U.S. Department of Justice Civil Rights Division (DOJ) conduct an investigation of the Baltimore Police Department (BPD). DOJ interviewed hundreds of individuals, including city leaders, community members, and current and former law enforcement personnel. DOJ also reviewed hundreds of thousands of pages of documents, including all relevant policies and training materials used by BPD beginning in 2010; BPD's database of internal affairs files from January 2010 through March 2016; BPD's data on pedestrian stops, vehicle stops, and arrests from January 2010 to May 2015; incident reports describing stops, searches, arrests, and officers' use of nondeadly force from 2010 to 2015; all files on deadly force incidents since 2010 that BPD was able to produce through May 1, 2016; and investigative files on sexual assault cases from 2013 to 2015. On August 10, 2016, DOJ released the results of its investigation.

Key Findings

DOJ determined that BPD engages in a pattern or practice of:

- making unconstitutional stops, searches, and arrests;
- using enforcement strategies that produce severe and unjustified disparities in the rates of stops, searches, and arrests of African Americans;
- using excessive force; and
- retaliating against people engaging in constitutionally protected expression.

DOJ concluded that this pattern or practice is at least partly the result of past "zero tolerance" policies, and continues to be driven by systemic deficiencies in BPD's policies, training, supervision, and accountability structures that fail to equip officers with the tools they need to police effectively and within legal bounds.

Stops

DOJ noted a widespread pattern of BPD officers stopping and detaining people on Baltimore streets without reasonable suspicion that the person was involved in criminal activity as required by the Fourth Amendment. BPD officers recorded over 300,000 pedestrian stops from January 2010 through May 2015, though the true number of BPD's stops during this period is likely far higher due to underreporting. The lack of sufficient justification for many of BPD's pedestrian stops was demonstrated by the extremely low rate at which stops uncovered evidence of criminal activity. In a sample of over 7,200 pedestrian stops reviewed by DOJ, only 271 – or 3.7% – resulted in officers issuing a criminal citation or making an arrest. DOJ also noted that even officers' own reports described facially unconstitutional conduct.

Searches

The investigation revealed that during pedestrian and vehicle stops, BPD officers regularly escalate encounters by conducting unlawful searches. This practice includes two types of conduct: (1) officers conducting weapons pat downs or “frisks” where they lack reasonable suspicion that a subject is armed and dangerous as required by the Fourth Amendment and (2) unconstitutional, pre-arrest strip searches in public areas that even contravene BPD's own policies. DOJ's review of incident reports and interviews with several hundred community members indicated that BPD's unconstitutional frisk practice is widespread, but DOJ was unable to precisely quantify the scope of these unconstitutional frisks because BPD does not reliably record when officers conduct a frisk.

Arrests

The investigation also determined that officers made thousands of unlawful arrests. DOJ established that unlawful arrests by BPD fell into three main categories: (1) warrantless arrests made without probable cause in violation of the Fourth Amendment; (2) arrests for minor offenses, such as failure to obey and trespassing, in circumstances that violate the Due Process Clause's requirement to provide fair notice of prohibited conduct; and (3) investigative detentions that exceed constitutionally permissible time limits and constitute arrests.

DOJ's review of data maintained by the State revealed that, from November 2010 through July 2015, supervisors at Baltimore City's Central Booking and Intake Center released 6,736 arrestees without charge. Further, the State's Attorney's Office declined to charge an additional 3,427 cases, explicitly concluding that 1,983 of the underlying arrests lacked probable cause. In sum, officers made 10,163 arrests (approximately 200 per month) that authorities immediately declined to prosecute, many of which were for nonfelony, highly discretionary offenses.

Excessive Force

DOJ's review of deadly and nondeadly force cases revealed that BPD engages in a pattern or practice of excessive force. DOJ determined that BPD uses (1) overly aggressive tactics that unnecessarily escalate encounters, increase tensions, and lead to unnecessary force, and fails to de-escalate encounters when it would be reasonable to do so; (2) excessive force against individuals with mental health disabilities or who are in crisis; (3) unreasonable force against juveniles; and (4) excessive force against individuals who are already restrained and under officers' control as well as individuals who are fleeing from officers and are not suspected of serious criminal offenses.

Discrimination against African Americans in Policing

DOJ also concluded that BPD engages in a pattern or practice of discrimination against African Americans in its law enforcement activities. This conclusion was supported by data in every category that DOJ evaluated. The investigation revealed that, in Baltimore, African Americans are disproportionately stopped, searched (including publicly strip searched), and arrested. BPD made roughly 44% of its stops in two predominantly African American districts that contain only 11% of the city's population. Additionally, 86% of all criminal offenses charged by BPD officers were against African Americans despite the fact that African Americans comprise only 63% of Baltimore residents. The investigation also revealed that African Americans are more likely to be wrongfully arrested and are more likely to be the victims of excessive force than other racial groups in the city.

In addition, DOJ concluded that the magnitude of the racial differences in BPD's stops, searches, and arrests are evidence that BPD's disproportionate enforcement may constitute intentional discrimination. DOJ found consistent racial disparities in BPD's stops, searches, and arrests that are not attributable to population patterns, crime rates, or other race-neutral factors.

Retaliation against Individuals Engaged in First Amendment Activities

DOJ determined that BPD violates the First Amendment by retaliating against individuals engaged in constitutionally protected activities. Officers frequently detain and arrest members of the public for engaging in speech the officers perceive to be critical or disrespectful. BPD officers also use force against members of the public who are engaging in protected speech.

Gender Bias in Processing Sexual Assault Cases

DOJ did not find reasonable cause to believe that BPD engages in gender-biased policing in violation of federal law. However, DOJ's interviews and review of BPD files suggested that

gender bias may be affecting BPD's handling of sexual assault cases. There were indications that officers failed to meaningfully investigate reports of sexual assault, particularly for assaults involving women with additional vulnerabilities, such as those who are involved in the sex trade.

Contributing Factors

Consistently throughout the report, DOJ ascribed many of the shortcomings of BPD to the "zero tolerance" policy embraced by city leadership beginning in the late 1990s. Rather than engaging in community-based policing, officers under zero tolerance were encouraged to "clear corners" with little regard for constitutionally protected activities. The zero tolerance policy emphasized the quantity of arrests made over the quality of arrests made.

More recently, city and police leadership have made efforts to transition to community-oriented policing, but the legacy of zero tolerance and the culture within BPD that it created have proven difficult to overcome, in part, according to DOJ, because of critical deficiencies in BPD's systems to train, equip, supervise, and hold officers accountable, and to build relationships with the broader Baltimore community. Specifically, the investigation noted that BPD:

- fails to adequately supervise its officers;
- lacks meaningful accountability systems to deter misconduct and does not consistently classify, investigate, adjudicate, or document complaints of misconduct;
- fails to have proper agreements in place to coordinate its activities with other agencies that are operating within its jurisdiction;
- does not engage effectively with the community it polices and fails to use accepted community policing strategies and transparency mechanisms; and
- fails to adequately support its officers with adequate staffing and material resources.

Moving Forward

Prior to the release of the report, DOJ and Baltimore City entered into an agreement in principle in an effort to avoid litigation against the city and to begin the process of instituting meaningful reforms to BPD. In the agreement, both parties committed to complete negotiations, with input from the community, for a court enforceable consent decree by November 1, 2016. In late October, Mayor Stephanie Rawlings-Blake announced that negotiations were continuing but would not be completed by the November 1 deadline. Once a consent decree is reached, DOJ and the city will engage community stakeholders, including BPD officers, to ensure a broad understanding of its terms.

Justice Reinvestment Act

Chapter 515 of 2016 created a framework of sentencing and corrections reforms with the goals of safely reducing the number of inmates in Maryland prisons, reinvesting the savings into more effective strategies to increase public safety, and at the same time, helping prevent nonviolent offenders from returning to prison. While the Justice Reinvestment Oversight Board has not yet been fully formed, a number of reports expected to assist in the work of the board are due by the beginning of 2017.

Justice Reinvestment Oversight Board

Chapter 42 of 2015 established the Justice Reinvestment Coordinating Council (JRCC) within the Governor's Office of Crime Control and Prevention (GOCCP). JRCC was required to use a data-driven approach to develop a statewide policy framework for sentencing and corrections policies to further reduce the State's incarcerated population, reduce spending on corrections, and reinvest in strategies to increase public safety and reduce recidivism. The council and its subcommittees met numerous times in 2015 to analyze criminal justice data and review relevant research. Based on its findings, JRCC developed a comprehensive set of recommendations intended to focus prison resources on serious and violent offenders, strengthen community supervision efforts, improve and enhance release and reentry practices, support local corrections systems, and ensure oversight and accountability.

Chapter 515 of 2016, the Justice Reinvestment Act (JRA), generally implements many of the recommendations of JRCC by altering provisions relating to sentencing, corrections, parole, and offender supervision. In addition, JRA (1) alters provisions relating to criminal gangs; (2) increases maximum penalties for second-degree murder and first-degree child abuse resulting in death; (3) modifies provisions regarding drug treatment; (4) expands expungement provisions; and (5) provides for the reinvestment of savings.

Most of JRA's provisions take effect October 1, 2017; however, many important organizational aspects of JRA requirements became effective October 1, 2016. JRCC was replaced by the Justice Reinvestment Oversight Board, tasked with generally monitoring progress and compliance with the recommendations of JRCC and implementation of JRA. The board consists of 24 members and is required to meet annually. The board is housed in GOCCP, which anticipates having board membership determined by November 2016.

The board must establish an advisory board of criminal justice stakeholders that will assist in the analysis and implementation of JRA. JRA also provides for a Local Government Justice Reinvestment Commission with a representative from each county to advise the board on

local impacts of implementing JRA and on local grant funding through the Performance Incentive Grant Fund. The membership of these groups will not be determined until the board is formed.

The Performance Incentive Grant Fund is a special fund that will be administered by GOCCP and make use of the savings accrued from implementing the JRA's provisions. Funding for the Performance Incentive Grant Fund will come from (1) savings realized from changes to the supervision abatement process; (2) savings from reducing the inmate population as a result of the entire JRA scheme; (3) money appropriated by the Governor; (4) interest; and (5) any other money from any other source. While the establishment of the Performance Incentive Grant Fund became effective October 1, 2016, any significant contributions will not be realized until well after the substantive provisions of JRA go into effect. For example, the first prison population comparison for savings to be appropriated to the fund will not be conducted until October 1, 2018. As a result, those funds will not be included in the operating budget until fiscal 2020.

Reports

There are a number of reports due to the Governor and General Assembly on or before January 1, 2017. The data and recommendations required to be in the reports are expected to be important for implementing the substantive provisions of JRA that take effect October 1, 2017. **Exhibit 1** lists all of the reporting requirements in JRA.

Exhibit 1
Justice Reinvestment Act Reporting Requirements

Agency	Report	Due Date	Frequency
GOCCP	Study the restitution system and the feasibility of centralizing victim services in a new State unit.	December 1, 2016	once
GOCCP, DPSCS, DHMH, Judiciary, public health and treatment professionals, and local corrections	Gap analysis of offender treatment needs and available services.	December 31, 2016	once
DPSCS, DHMH, and DLLR ¹	Review barriers to employment for people with criminal records and make recommendations for changes to occupational licensing laws.	December 31, 2016	once
DHMH, local corrections, local health departments	Budget requirement analysis of JRA and plan for meeting requirements.	December 31, 2016	once
Maryland Mediation and Conflict Resolution Office	Study and identify best practices for criminal referrals to mediation.	January 1, 2017	once
JROB	Status of JRA implementation and projected financial impact on local jurisdictions and corrections.	January 1, 2017	once
JROB and LGJRC	Report on board and commission.	December 31, 2017	annually
Sentencing Commission	Study how alternatives to incarceration may be included in sentencing guidelines.	January 1, 2018	once

Agency	Report	Due Date	Frequency
JROB and DPSCS	Determine savings from reduction of inmate population.	October 1, 2018	annually
AOC	Number of § 8-505 Health-General drug treatment assessments ordered in prior calendar year.	March 1, 2017	annually
DPP and each county	Data regarding pretrial detention.	March 31, 2017	annually
DHMH	Data on drug treatment evaluations and commitments.		quarterly
DPSCS, each county, Parole Commission, AOC, and Sentencing Commission	Data regarding jail admissions, sentencing, length of sentences, departure from technical caps, <i>etc.</i>		semiannually

AOC: Administrative Office of the Courts

DHMH: Department of Health and Mental Hygiene

DLLR: Department of Labor, Licensing, and Regulation

DPP: Division of Parole and Probation

DPSCS: Department of Public Safety and Correctional Services

JROB: Justice Reinvestment Oversight Board

GOCCP: Governor's Office of Crime Control and Prevention

LGJRC: Local Government Justice Reinvestment Commission

¹ In December 2015, the Governor directed GOCCP to create a study group to study barriers ex-offenders face when released from prison. The workgroup has been created, has conducted meetings, and will be contributing to this required report.

Source: Chapter 515 of 2016

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Public Safety

State Correctional System

Correctional, detention, and supervision populations have continued to decline slowly. The decline has allowed the Department of Public Safety and Correctional Services to close aging facilities in Baltimore City and relocate inmates to other State facilities. The department has struggled recently with vacancies among correctional officer positions and renewed concerns regarding facility safety and security.

Background

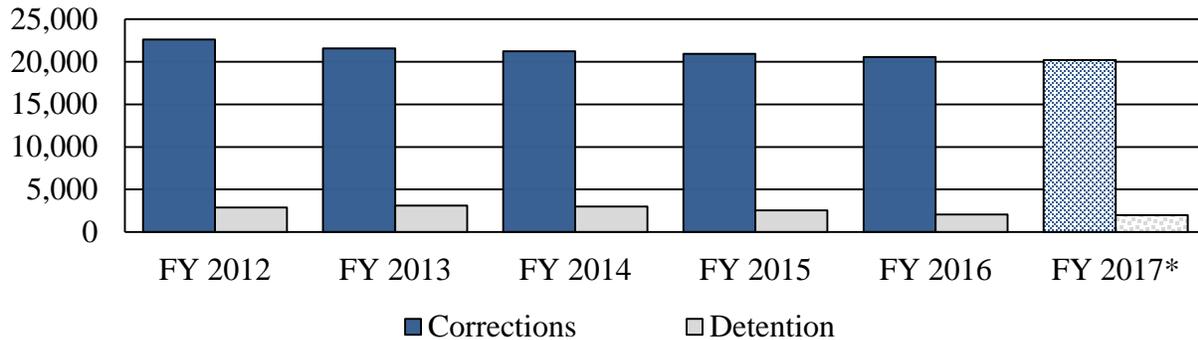
The Department of Public Safety and Correctional Services (DPSCS) is a principal department of State government, the primary functions of which include the operation of 21 State correctional and Baltimore City detention facilities, as well as the supervision of offenders in the community who are on parole or probation. With nearly 11,000 employees and a fiscal 2017 budget in excess of \$1.4 billion, DPSCS accounts for 13.6% of the total State workforce and 7.1% of general fund expenditures.

Population Trends

The overall population of offenders housed under DPSCS jurisdiction has steadily declined over the past decade. **Exhibit 1** shows the average daily population (ADP) of individuals in DPSCS custody (sentenced and detained) between fiscal 2012 and the first quarter of fiscal 2017. Between fiscal 2012 and 2016, the ADP has declined by nearly 3,300 individuals, or 11.2%. Data from the first quarter of fiscal 2017 indicates a continued slow decrease in the population.

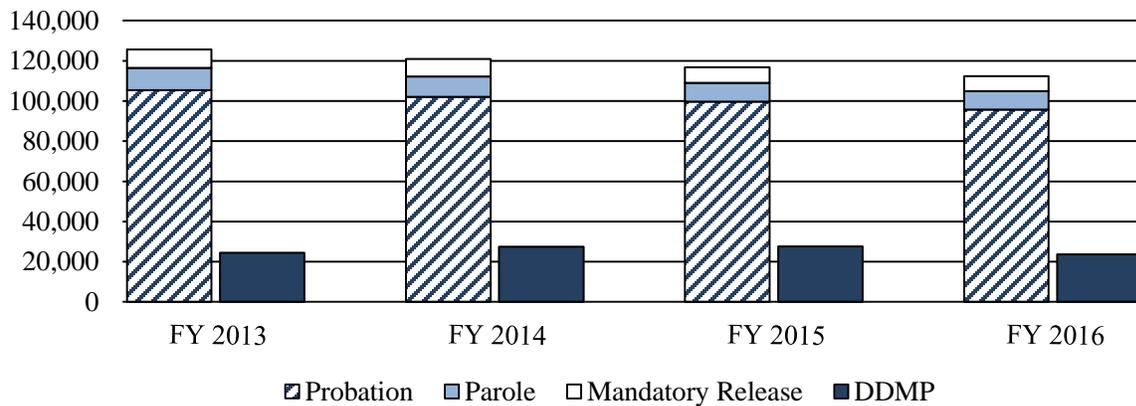
As seen in **Exhibit 2**, between fiscal 2013 and 2016, the total number of criminal cases (which includes parole, probation, and mandatory release) supervised each year decreased by slightly more than 14,800, or 11.5%. Over 80% of the total reduction is the result of a decrease in probation cases, which is the largest population supervised by the Division of Parole and Probation (DPP). Proportionally, mandatory release cases saw the largest decrease, by 28.3%. DPP also supervises offenders in the Drinking Driver Monitor Program (DDMP). DDMP cases supervised each year also decreased over the past five years, by nearly 3,200 cases, or 11.9%. In 2016, DPP supervised a total of 114,116 criminal supervision cases and 23,694 DDMP cases.

Exhibit 1
Department of Public Safety and Correctional Services
Average Daily Population
Fiscal 2012-2017



*Fiscal 2017 data only reflects the average for the first quarter.
 Source: Department of Public Safety and Correctional Services ADP reports

Exhibit 2
Community Supervision Cases
Fiscal 2013-2016



Source: Department of Public and Correctional Services Managing for Results Data

Capital Plan and Facility Openings and Closures

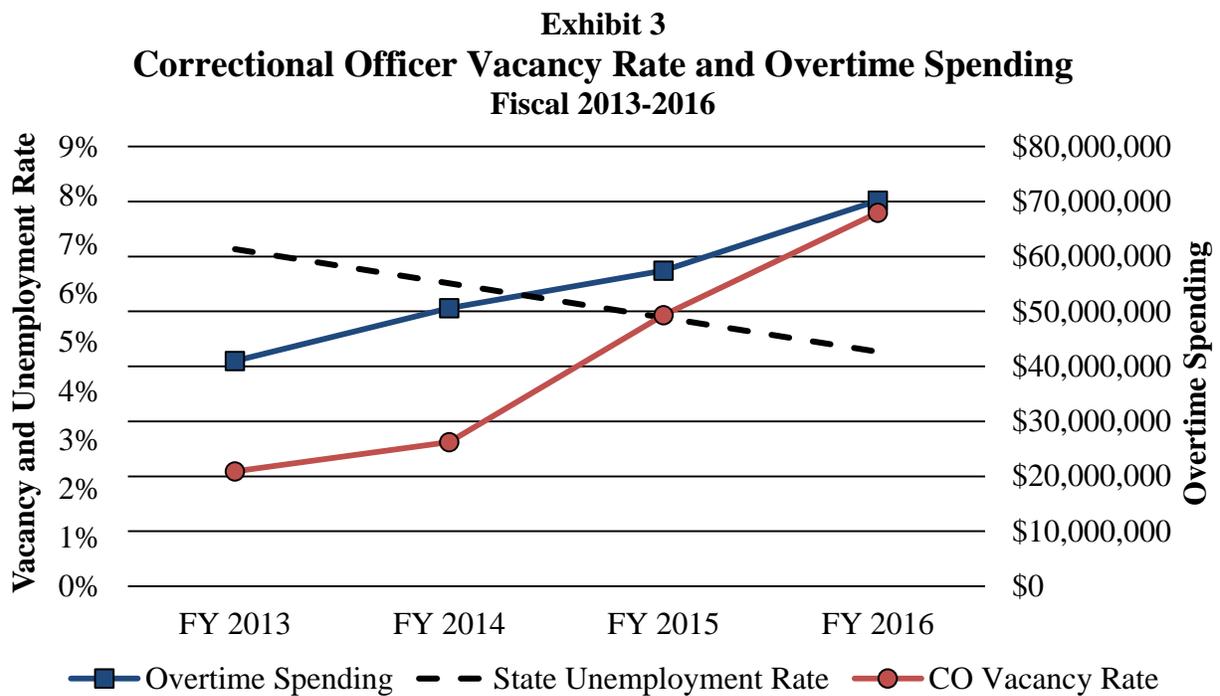
Consistent with the declining inmate population, the Governor’s five-year *Capital Improvement Program* focuses on improving services and support space, as well as replacing aging and inefficient facilities. The fiscal 2017 capital budget includes funding to complete the Baltimore City Youth Detention Center, which will accommodate pretrial youth who are detained while awaiting charges in adult court. This project originated with an investigation

by the U.S. Department of Justice indicating the conditions in the existing detention center facility do not provide adequate program or education space for youth charged as adults and do not comply with sight and sound separation requirements. The new 60-bed facility is estimated to cost \$37.4 million in total and become operational at the end of fiscal 2017.

Over the past two years, the department has also been in the process of closing various Baltimore City detention facilities deemed structurally unfit to safely house inmates. In August and September 2015, DPSCS depopulated the Men’s Detention Center and transferred pretrial and sentenced inmates to several other State facilities. In October 2016, DPSCS depopulated the existing Baltimore City Women’s Detention Center, again citing safety and structural concerns. Inmates have been relocated to another facility within the Baltimore Pretrial Complex. Although some vacant correctional officer positions have been reclassified to meet other needs, these facility closures have not resulted in the loss of any personnel.

Correctional Officer Recruitment and Retention

Issues with correctional officer recruitment and retention have plagued the department for a number of years and have resulted in significantly increased overtime expenditures and correctional officer resignations. Fiscal enhancements implemented in fiscal 2006, combined with additional efforts by DPSCS, had positive effects on staffing needs. However, recent budgetary cuts and a decrease in the State unemployment rate have again resulted in a reduction of filled correctional officer positions and an increase in overtime spending, as shown in **Exhibit 3**.



Source: Department of Public Safety and Correctional Services Budget Data

Facility Safety and Security

On October 5, 2016, federal authorities indicted 80 people, including 18 correctional officers and 35 inmates, alleging conspiracy to bring heroin, cocaine, cellphones, pornography, and other contraband into the Eastern Correctional Institution (ECI). Investigation into the case began in 2013 with a tip from a correctional officer. ECI is a medium security facility located in Westover (Somerset County). With an average daily population of about 3,200 inmates, it is the State's largest correctional facility.

Though the scale is much larger, there are similarities between the ECI indictments and the 44 indictments at the Baltimore City Detention Center (BCDC) in 2013. Following the 2013 issues with corruption and security within the department, DPSCS implemented a variety of enhancements to address concerns, including:

- implementation of managed access systems at facilities, starting with BCDC, to curb the illegal use of cell phones by inmates;
- investment in additional security cameras and upgrades to video recording systems;
- realignment of existing vacancies in order to expand the Internal Investigative Division and the employee hiring and recruitment functions, including the creation of an Applicant Polygraph Unit (Chapter 407 of 2015 requires all correctional officer applicants to take a polygraph test); and
- increased in-service training hours for correctional officers, to the nationally accepted standard of 40 hours annually.

Although many of the enhancements have benefited facilities statewide, some enhancements, such as the cell phone managed access systems, have exclusively been implemented in Baltimore City facilities.

Firearms – Terrorist Watchlist

Following the September 11, 2001 terrorist attacks on the United States, President George W. Bush issued a presidential directive to integrate and consolidate screening information among government agencies to protect against terrorism. The Terrorist Screening Center within the Federal Bureau of Investigation maintains and operates the U.S. government's consolidated Terrorist Screening Database. Legislation has been introduced on both the federal and state levels to restrict access to firearms for individuals included in the database. However, many questions have been raised regarding use of the database for this purpose.

Firearms and the Terrorist Screening Database

The Terrorist Screening Center within the Federal Bureau of Investigation (FBI) maintains and operates the U.S. government's consolidated Terrorist Screening Database (TSDB), often referred to as the "Terrorist Watchlist." TSDB serves as a single database of identifying information about those known to be or reasonably suspected of being involved in terrorist activity. A person may be included in TSDB when nominated by a U.S. government agency based on reasonable suspicion that the person is a known or suspected terrorist.

The federal Brady Handgun Violence Prevention Act requires federal background checks on firearms purchasers in the United States. The FBI and state and local criminal justice agencies conduct the checks using the FBI's National Instant Criminal Background Check System (NICS). A NICS denial must be based on federal or state statutory prohibitions. Current federal law does not explicitly prohibit those included in TSDB from possessing a firearm or purchasing a firearm from a licensed gun dealer. As a result, a transaction to a person who is a suspected terrorist may be denied only if the person is statutorily prohibited from possession by a disqualifier (such as a prior felony conviction). If NICS does not provide a denied response based on a disqualifying factor within three days, the person may receive a firearm. NICS may only continue to investigate the transaction for up to 90 days, but assigned FBI agents may use information obtained from the NICS transaction to support terrorism investigations.

According to the U.S. Government Accountability Office (GAO), approximately 23.1 million background checks were processed through NICS during calendar 2015. FBI data shows that, of those 23.1 million background checks, 244 involved individuals in TSDB. About 91% of those transactions were allowed to proceed. The transactions that were denied were based on statutory prohibiting factors (such as a felony conviction or a pending indictment). Since NICS started checking against TSDB in February 2004, individuals were involved in a total of 2,474 firearm-related background checks, of which 212 were denied. **Exhibit 1** shows combined firearm and explosive background checks involving individuals in TSDB. (Since 2004, only 3 explosive checks were conducted on individuals in TSDB).

Exhibit 1
Number of Firearm or Explosive Background
Checks Involving Individuals in TSDB
February 2004-December 2015

<u>Calendar Year</u>	<u>Valid Matches</u>	<u>Allowed to Proceed¹</u>		<u>Denied</u>	
2004	48	43	90%	5	10%
2005	149	141	95%	8	5%
2006	179	153	85%	26	15%
2007	287	259	90%	28	10%
2008	246	228	93%	18	7%
2009	272	250	92%	22	8%
2010	272	247	91%	25	9%
2011	142 ²	130	92%	12	8%
2012	153 ²	137	90%	16	10%
2013	256	240	94%	16	6%
2014	229	214	93%	15	7%
2015	244	223 ³	91%	21	9%
	2,477 ⁴	2,265	91%	212	9%

¹The FBI does not know how often a firearm was actually transferred or whether a firearm or explosives license or permit was granted.

²FBI statistics for certain NICS transactions during calendar 2011 and 2012 are not complete due to computer programming issues.

³As of February 29, 2016, the FBI was continuing to research 7 of 223 transactions for potentially prohibiting information.

⁴Of the 2,477 total transactions, 2,474 involved firearm background checks and 3 involved explosive checks.

Source: GAO analysis of FBI data

Federal and State Legislation

In response to recent terrorist acts involving firearms, both nationally and internationally, there has been a push on both the federal and state levels to restrict access to firearms for individuals who appear in TSDB. In 2015, legislation was introduced in Congress to address the issue; however, nothing passed. States have also attempted to address the issue through legislation. In 2013, New Jersey passed legislation prohibiting an individual in TSDB from purchasing a firearm; however, neither New Jersey State Police nor licensed firearms dealers have direct access to the watchlist and must rely on the NICS screening process to reject suspected terrorists. In 2015, Connecticut Governor Dannel Malloy announced that once he received permission from the

federal government to have access to the list he would sign an executive order banning individuals in TSDB from purchasing a firearm. The executive order remains unsigned. Other states, including New York, Illinois, and California have considered similar legislation.

The Maryland General Assembly considered action on the issue during the 2016 legislative session. Senate Bill 1040/House Bill 1000 would have prohibited the Department of State Police from issuing a wear, carry, or transport permit for a handgun to an individual in TSDB. Neither bill passed. Most public and legislative opposition stemmed from the lack of information regarding TSDB. Specifically, the American Civil Liberties Union of Maryland expressed concern about errors in the maintenance of such a list.

Countervailing Issues

Certain countervailing issues should be considered in conjunction with any legislation seeking to prohibit purchase of firearms by those included in TSDB.

Security Investigations

Any law prohibiting an individual included in TSDB from purchasing or possessing a firearm must also consider preserving the ability of the FBI to conduct national security investigations. FBI agents conducting terrorist investigations may require flexibility and discretion in denying firearms at the point of purchase. For example, during an ongoing investigation, agents may want to allow a sale to be approved in order to obtain additional evidence of terrorist activity or expand the reach of a terrorism investigation. A strict prohibition would not allow this flexibility. Additionally, a strict prohibition may compromise an investigation if an individual in TSDB attempts to purchase a firearm for the purpose of determining whether that individual is under investigation.

Challenges to Denial

A statute may be held unconstitutional if it results in a deprivation of a constitutionally protected liberty or property interest without providing an affected individual an opportunity to be heard at a meaningful time and in a meaningful manner. Because the Supreme Court has determined that the Second Amendment right to bear arms is an individual right, due process requires that an individual be entitled to challenge a denial of the right. This requirement faces practical issues at the federal level. In order to defend its decision to deny an individual a firearm because the person is included in TSDB, the government would have to expose the classified information used to place the individual in TSDB. Exposure of the information may inhibit ongoing terrorism investigations or reveal sensitive intelligence information. Any law establishing a prohibition for an individual in TSDB would have to permit an individual to challenge the denial while still protecting the classified federal information used to place that person in TSDB.

Additionally, currently there is no mechanism for the federal government to give classified information to the states, and NICS has no internal mechanism for protecting classified information. Because states do not and currently cannot have access to classified information, any challenge to a state denial would have to be taken up at the federal level. This would require the collaborative development of a federal system for litigation of this issue, which does not currently exist and which the states cannot mandate into existence.

Criminal Law

Bail Reform

A nationwide movement to reform the bail system is moving through legislatures and the courts. Research suggests that many criminal defendants remain in jail awaiting trial solely because they cannot afford to post bail, putting them at risk of losing their jobs, custody of their children, and more. The practice also appears to disproportionately impact minorities and the poor.

Background

When an individual is charged with a crime, Maryland law currently allows District Court commissioners and judges to permit release on personal recognizance, set a bail amount, or order pretrial detention. To meet a bail amount, an arrestee must either make a payment directly to the court (cash bail) or seek the assistance of a bail bondsman.

Bail systems have come under increased scrutiny nationwide due to the disproportionate financial burden placed on lower income individuals and the risk that they will be held before trial solely because of their financial status. Advocates for bail reform contend that alternative pretrial release strategies perform as well as or better on court appearance rates and public safety without imposing a disparate impact on low-income defendants. While a legislative task force and an Executive Branch commission have studied the State's pretrial system and have recommended that the money bail system be eliminated and replaced with a statewide pretrial system built on validated risk assessment, the General Assembly has failed to pass legislation to implement such a system.

Recent Activity by the U.S. Department of Justice

In February 2015, the U.S. Department of Justice (DOJ) filed a statement of interest in a case pending in federal district court in Alabama, *Varden v. City of Clanton*, in which an arrestee was held for a week because she could not afford to pay the preset bail for her charges. The DOJ statement argued that such fixed-sum bail schemes violate the equal protection clause of the Fourteenth Amendment because "they essentially mandate pretrial detention for anyone who is too poor to pay the predetermined fee." The DOJ statement went further to argue that systems that put too much emphasis on bail are bad public policy because they have a "tendency to cause unnecessary incarceration of defendants who cannot afford to pay secured financial conditions" and "allow for, and sometimes foster, the release of high-risk defendants" with more financial resources. The case was settled shortly after DOJ filed its statement. Under the settlement agreement, the city agreed to release most individuals arrested for violations of city ordinances on unsecured bonds and to conduct a bail hearing within 48 hours after arrest for anyone who was not released.

In August 2016, DOJ filed an *amicus curiae* brief in *Walker v. City of Calhoun, Georgia* stating that a bail system that required an arrestee to pay a fixed amount violated the Fourteenth Amendment because it failed to engage in a meaningful consideration of the arrestee's ability to pay the bail and alternatives to money bail. The plaintiff in the case alleged that he was kept in jail for six days because of his inability to pay a \$160 bail, which was determined according to the City of Calhoun's preset bail schedule.

In January 2016, a federal district court granted Mr. Walker's request for a preliminary injunction and ordered the City of Calhoun to implement constitutional post-arrest procedures. The court also prohibited the city from keeping arrestees in custody solely because of their inability to pay their monetary bonds and ordered the city to release present and future misdemeanor arrestees in its custody on personal recognizance or unsecured bond until it can implement lawful procedures. The court also granted Mr. Walker's motion for class certification. The case is currently in the U.S. Court of Appeals for the Eleventh Circuit.

Though the *Varden* and *Calhoun* cases involve bail schedules and preset bail amounts, DOJ officials have stated that the department's position applies to any system that incarcerates an individual solely because of the individual's inability to pay a cash bond, fee, or fine.

Validated Risk Assessments

Advocates for bail reform point to validated risk assessments as a potential alternative to the money bail system. Validated risk assessments use a survey to evaluate arrestees on factors (such as ties to the community, criminal history, and employment status) that correlate to their likelihood to reoffend or to fail to appear for court. Arrestees are assigned a risk score based on this assessment that judges can weigh when deciding whether arrestees should be released without financial conditions. Early results from jurisdictions that have implemented such systems, including Kentucky and Colorado, have found that validated risk assessments allow courts to identify and release low-risk arrestees, while still achieving similar or slightly better public safety results than money bail systems. However, recent reporting by ProPublica shows that some risk assessments may be biased against African American inmates and have mixed success evaluating likelihood to reoffend.

The General Assembly's Task Force to Study the Laws and Policies Relating to Representation of Indigent Criminal Defendants by the Office of the Public Defender and the Governor's Commission to Reform Maryland's Pretrial System recommended a statewide pretrial system for Maryland based on validated risk assessment in 2013 and 2014, respectively. The Abell Foundation has also recommended the adoption of a risk-based pretrial system and elimination of money bail as recently as June 2016. However, the General Assembly has failed to pass legislation to implement such a system.

The Status of Bail in Maryland

Maryland does not utilize preset bail schedules or fixed-sum bail systems. Rather, judges and commissioners in Maryland are required to consider a number of factors when determining whether an arrestee is to be held in pretrial detention, released with a money bail, or released on recognizance. Under Maryland Rule 4-216(e)(1), a judicial officer is required to consider a number of factors relating to the charges, potential danger to the community, and likelihood that the individual will appear when required if released. According to information provided by the Maryland Judiciary during the 2016 session, approximately 50% of arrestees are released immediately on personal recognizance or by unsecured personal bonds, 10% post bonds the same evening, and 10% post bonds prior to a judicial bail review hearing.

In an advisory letter dated October 11, 2016, the Office of the Attorney General stated its belief that, if presented with an appropriate case, the Court of Appeals would determine that the State's laws and rules require judicial officers to inquire into an arrestee's ability to meet a financial condition of release. The advisory letter concluded that if a judge or commissioner determines that pretrial detention without bail is not necessary, then they "may not impose a financial condition set solely to detain the defendant," and release conditions must be the "least onerous" possible to meet the State's interests in public safety and ensure the appearance of the defendant. The office also determined that if bail is set at a financially unreachable level for a defendant for whom pretrial detention is not justified, the Court of Appeals would likely determine that the bail is excessive under the Eighth Amendment of the U.S. Constitution and Article 25 of the Maryland Declaration of Rights. Currently, State law does not require that bail be set within an arrestee's ability to pay.

The Chief Judge of the District Court of Maryland, John P. Morrissey, issued a guidance letter to all District and circuit court judges and District Court Commissioners on October 25, 2016, advising them on several aspects of the bail-setting process under current law. In particular, Chief Judge Morrissey cautioned that judicial officers are to apply the "least onerous" conditions that will ensure public safety and the appearance of the defendant and that cash bail is not an appropriate means of ensuring public safety. He also advised that judicial officers should avoid "defendants being detained who do not need to be detained."

Also on October 25, 2016, Maryland Attorney General Brian E. Frosh requested that the Maryland Judiciary's Standing Committee on Rules of Practice and Procedure consider changes to the Maryland Rules to ensure that arrestees do not remain incarcerated solely because they cannot afford bail, but did not recommend the adoption of a specific risk assessment tool. The 24-member panel considers proposed amendments to the Maryland Rules of Procedure and submits recommendations for amendments to the Court of Appeals. On November 18, 2016, the committee voted to recommend the adoption of a new Rule 4-216.1 to set standards governing pretrial release. Among other things, the proposed rule authorizes a judicial officer to impose financial conditions only when no other conditions of release will reasonably ensure the defendant's appearance. The rule prohibits the imposition of a financial condition that a judicial officer knows or has reason to believe the defendant is financially incapable of meeting and that

will result in the defendant being detained solely because of that reason. In determining the form and amount of a financial condition, the judicial officer must give preference, whenever possible, to selecting a form and amount that the defendant can satisfy.

The proposed rule further states that financial conditions of release are appropriate only to ensure the appearance of the defendant and may not be imposed solely to prevent future criminal conduct during the pretrial period or to protect the safety of any person or the community; nor may they be imposed to punish the defendant or to placate public opinion. The defendant should not be released if a finding is made that there is a reasonable likelihood that the defendant will not appear when required or will be a danger to an alleged victim, another person, or the community.

Unless otherwise directed by the Court of Appeals, there is ordinarily a 30-day comment period before the Court of Appeals holds a public hearing on proposed changes to the Maryland Rules. Any changes must be adopted by the court by issuance of a Rules Order.

Expungement and Shielding

Prompted by recognition that nonviolent offenders face significant barriers in becoming fully functioning, productive members of society, legislation in the past several years has greatly increased opportunities for nonviolent offenders with criminal records to shield or expunge police and court records. Lack of access to housing, employment, and educational opportunities has been cited as a contributing factor to the high rate of recidivism among nonviolent offenders.

Introduction

According to the U.S. Department of Justice, 9,466 prisoners with a sentence of more than one year were released in Maryland during 2014, the most recent year for which this data is available. The ability of former prisoners to become productive, contributing members of society has been part of an ongoing national debate. Ex-offender reentry is viewed by many in the criminal justice community as a key component of reducing the recidivism rate and as a step toward America's prisons serving a rehabilitative function and representing a better investment of taxpayer dollars.

The ability of ex-offenders to obtain gainful employment is an important part of the reentry process. However, many ex-offenders attest that the mere existence of a criminal record eliminates them from consideration for many jobs or prevents them from progressing past the preliminary stages of the job-seeking process. The presence of a criminal record may also create challenges in other aspects of successful reentry, such as obtaining housing.

Chapters 625 and 626 of 2009 established the Task Force on Prisoner Reentry. The task force was charged with several duties, including analyzing the statutory, regulatory, rules-based, and practice-based hurdles to reintegration of adult and juvenile offenders into the community. The task force issued a final report of its findings and recommendations in 2011. One of the task force recommendations was to shield from public view criminal records for nonviolent convictions after an appropriate waiting/proving period, with provisions for full access for law enforcement and relevant parties.

There are two primary methods through which a person may seek to limit access to his or her court or police record – expungement and shielding. Expungement removes court and police records from public inspection. Expunged records may only be opened upon court order and are kept separately for three years and then destroyed. Shielding typically involves retaining the record, but rendering a court record and/or police record relating to specified events inaccessible by members of the public. Both expungement and shielding remove references to a record from the Maryland Judiciary's Case Search website.

Expungement and Shielding Legislation

The Maryland General Assembly has considered several bills in recent years to expand the availability of expungement and shielding of records, most notably in 2015 and 2016. Prior to 2015, the only records authorized for shielding were court records pertaining to domestic violence proceedings in which the petition had been dismissed. Chapter 313 of 2015 authorizes a person to petition a court to shield the person's court records and police records relating to a conviction for 1 or more of a list of 12 specified crimes that was entered in the circuit court or the District Court in one county, no earlier than three years after the person satisfies the sentence imposed for all convictions for which shielding is requested. This authorization does not apply to a conviction for a domestically related crime. A person may be granted only one shielding petition over the lifetime of the person, and a court may grant a shielding petition for good cause.

Chapter 374 of 2015 expands eligibility for expungements to persons convicted of a crime where the act on which the conviction was based is no longer a crime.

Chapter 314 of 2015 repeals provisions of law specifying that a person is not entitled to expungement if the petition for expungement is based on *nolle prosequi*, *stet*, other specified dispositions or the grant of a pardon by the Governor, and the person to whom the petition applies has subsequently been convicted of a crime (other than a minor traffic violation) or is a defendant in a criminal proceeding. Under Chapter 314, a person is not entitled to expungement if the petition for expungement is based on the entry of probation before judgment, (except a probation before judgment for a crime where the act on which the conviction is based is no longer a crime) and the person is a defendant in a pending criminal proceeding or was convicted of a crime (other than a minor traffic violation or a crime where the act on which the conviction is based is no longer a crime) within three years after the entry of the probation before judgment.

Chapter 515 of 2016, also known as the Justice Reinvestment Act (JRA), is the most comprehensive criminal justice-related legislation the Maryland General Assembly has passed in recent years. Among other things, Chapter 515 expands eligibility for expungement as of October 1, 2017, to include convictions for numerous specified misdemeanors, including misdemeanors for criminal contempt, failure to appear, and some fraud and theft offenses. A petition for expungement under Chapter 515 may not be filed earlier than 10 years after the person satisfies the sentence or sentences imposed for all convictions for which expungement is requested. A longer waiting period applies to specified domestically related crimes. If the person is convicted of a new crime during the waiting period, the original conviction(s) are not eligible for expungement unless the new conviction becomes eligible for expungement. A person is not eligible for expungement under Chapter 515 if the person is a defendant in a pending criminal proceeding. Prior to JRA, the only convictions eligible for expungement were convictions for specified public nuisance crimes, such as loitering and vagrancy.

JRA also includes provisions requiring the Department of Health and Mental Hygiene; the Department of Labor, Licensing, and Regulation; and the Department of Public Safety and Correctional Services to make recommendations regarding (1) potential barriers to employment, licensing, and entrepreneurship for individuals with a criminal record and the impact of

criminalization of occupational license violations; (2) changes to occupational licensing laws that protect the integrity of professional occupations while promoting the State’s interest in maintaining public safety; and (3) reducing costs and burdens to the criminal justice system, while increasing consistency with the uniform application of the occupational licensing laws across all State agencies.

Workgroup on Collateral Consequences of Convictions

On December 16, 2015, Governor Hogan announced the creation of the Workgroup on Collateral Consequences of Convictions, to be led by the Governor’s Office of Crime Control and Prevention. The workgroup is a multi-agency initiative tasked with reviewing the legal and regulatory barriers individuals with criminal records face when they re-enter the community after incarceration. The workgroup consists of 14 members representing State agencies, nonprofit groups, higher education professionals, and the business community. The workgroup held its first meeting on September 1, 2016, and held stakeholder meetings throughout the fall. Witnesses at some of the meetings testified about the difficulties they faced in obtaining employment because of their criminal records, despite education and/or vocational training they received prior to or during incarceration that made them qualified job applicants. The workgroup plans to submit its final report in December 2016.

Courts and Civil Proceedings

Punitive Damages

During the 2015 and 2016 legislative sessions, the Maryland General Assembly considered legislation that would have allowed plaintiffs to recover punitive damages in certain cases involving drunk driving. Although no legislation passed, the House of Delegates has convened a workgroup to study the issue of punitive damages generally before the 2017 session.

Introduction

Actual damages, also known as compensatory damages, are intended to make a plaintiff whole by returning the plaintiff to the position he or she was in prior to the alleged harm caused by the defendant. Actual damages include both economic damages – compensation for things like lost wages, medical expenses, and costs to repair or replace property – and noneconomic damages – compensation for things like pain, suffering, inconvenience, physical impairment, loss of consortium, or other nonpecuniary injury.

In contrast to actual damages, punitive damages do not compensate plaintiffs for their losses. Rather, punitive damages are designed to punish and deter blameworthy behavior. Under Maryland law, punitive damages are available only in a narrow category of cases – either where explicitly authorized by statute, or where the defendant’s conduct rises to the level of “actual malice.” In recent years, the General Assembly has considered legislation that would expand the use of punitive damages, particularly in cases involving drunk driving.

Availability of Punitive Damages in Maryland

Maryland Case Law

In *Owens-Illinois v. Zenobia*, 325 Md. 420 (1992), the Maryland Court of Appeals held that, in a nonintentional tort action, the trier of fact may not award punitive damages unless the plaintiff establishes that the defendant’s conduct was characterized by “actual malice” – meaning evil motive, intent to injure, ill will, or fraud. The court expanded on this decision in *Komornik v. Sparks*, 331 Md. 720 (1993), holding that evidence of the defendant’s driving while intoxicated is insufficient to support a finding of actual malice. *Zenobia* and *Komornik* explicitly overruled earlier decisions by the Court of Appeals that had established a gross negligence standard for the award of punitive damages in motor vehicle cases and had allowed courts to weigh evidence of a defendant’s intoxication on the issue of punitive damages.

Maryland’s actual malice standard is one of the strictest in the country. According to a survey by the national law firm Wilson Elser, of the 43 states where punitive damages are generally

available, it appears that only nine (California, Kentucky, Maine, Maryland, Montana, Nevada, North Dakota, Ohio, and Virginia) require proof of actual malice. Other states authorize punitive damage awards based on evidence that the defendant acted with “conscious disregard” of the likely consequences of his or her actions, “reckless indifference” to the likely consequence of his or her actions, or “gross negligence.” Moreover, most states that require proof of actual malice further distinguish between “express malice” and “implied malice.” Express malice exists where the defendant’s tortious conduct is motivated by ill will (*i.e.*, hatred, spite, or similar motive toward the plaintiff). Implied malice exists where the defendant’s conduct, although not necessarily motivated by ill will, is so outrageous that the court may infer malice on the part of the defendant. Maryland and North Dakota appear to be the only states to require proof of express malice to obtain punitive damages.¹

Maryland Statutes

Punitive damages are also available under more than 40 Maryland statutes. These statutes generally apply to legislatively created causes of action based on intentional misconduct. Nearly half of the statutes are intended to protect consumers. Usually, the statutes place a limit on the amount of the punitive damages that may be recovered in the form of a multiple of the actual damages.

Proposed Legislation

During the 2015 and 2016 legislative sessions, the Maryland General Assembly considered legislation that would have allowed plaintiffs to recover punitive damages in some drunk driving cases. Senate Bill 605 of 2015 would have authorized a finder of fact to award punitive damages in cases where the defendant caused personal injury or wrongful death while driving or attempting to drive a motor vehicle with an alcohol concentration of 0.15 or more. Senate Bill 605 passed the Senate and received an unfavorable report from the House Judiciary Committee.

Similarly, Senate Bill 302 of 2016 would have authorized an award of punitive damages against a person who causes personal injury or wrongful death while committing an alcohol-related driving offense if the injury or death was caused by a person who is a repeat offender (within the past 10 years) and the person meets one of two other sets of criteria:

- the person was operating or attempting to operate a noncommercial motor vehicle with an alcohol concentration of 0.15 or more; or
- the person (1) is detained by a police officer who has reasonable grounds to believe the person has been operating or attempting to operate either a noncommercial motor vehicle

¹ There is a possible exception to the express malice requirement in Maryland. In product liability cases, Maryland courts have found that the “actual malice” necessary to support an award of punitive damages is actual knowledge of a defect and deliberate disregard of the consequences. (*ACandS v. Godwin*, 340 Md. 334 (1995)). This is essentially an implied malice standard.

while under the influence of alcohol or impaired by alcohol or a commercial motor vehicle with any alcohol concentration in the person's blood or breath and (2) refuses to submit to a test to determine alcohol concentration.

Senate Bill 302 of 2016 passed the Senate and received a hearing in the House Judiciary Committee. No further action was taken on the bill.

House Workgroup on Punitive Damages

The House of Delegates has convened a workgroup to study issues related to punitive damages before the start of the 2017 session. The workgroup includes members of the Economic Matters, Health and Government Operations, and Judiciary committees. The workgroup's objectives include:

- reviewing the current structure for awarding punitive damages under Maryland law to determine whether the range of covered actions should be expanded or limited;
- examining other states' punitive damages schemes to determine whether there are best practices that Maryland should adopt;
- reviewing the opportunities for treble damages and compensatory damages under Maryland law; and
- determining what impact any expansion or contraction of punitive damages and treble damages would have on insurance consumers in the State.

The workgroup is scheduled to hold three meetings in November and December of 2016. It is possible that punitive damage legislation will be introduced during the upcoming session as a result of the workgroup's discussions.

Courts and Civil Proceedings

Termination of Parental Rights of Father of Child Conceived Without Consent

Recent federal legislation provides additional grant funding for states that have enacted laws to allow the mother of any child conceived through rape to seek court-ordered termination of the parental rights of the rapist upon clear and convincing evidence of rape. Efforts to enact similar legislation in Maryland, most recently in 2016, have been unsuccessful.

Background

The National Conference of State Legislatures (NCSL) reports that various studies over the last two decades estimate that between 17,000 and 32,000 rape-related pregnancies occur in the United States every year. Studies vary widely on the outcome of pregnancies resulting from rape. For example, one study found that 26% of women who became pregnant through rape underwent abortions. Of those women who carried their pregnancies to term, 64% raised the children and the remainder of the women placed the children for adoption. Another study found that approximately half of the women who became pregnant by rape underwent abortions. In some states, including Maryland, a man who fathered a child through rape may assert or attempt to assert parental rights over the child. Parental rights may include the rights to custody and visitation, as well as the right to consent before a child can be adopted.

Current Maryland Law

Maryland law does not contain specific provisions limiting or terminating the parental rights of an individual who fathered a child through rape. Under current law, parents are the joint natural guardians of their minor child, and courts are guided by the best interest of the child in making custody and visitation decisions. The General Assembly has limited the discretion of the courts to award custody or visitation in cases where there is a finding that a party has committed “abuse” (which includes rape or sexual offense) toward the other parent of the party’s child, the party’s spouse, or any child in the party’s household. However, courts have not denied all visitation except under exceptional circumstances. For example, in *Arnold v. Naughton*, 61 Md. App. 427 (1985), *cert. denied*, 303 Md. 295 (1985), the Court of Special Appeals held that a finding that a noncustodial parent sexually abused the child did not preclude all visitation rights to that parent. A court could order limited, supervised visitation without abusing its discretion.

When determining whether to terminate a parent’s rights to a child, a juvenile court must give primary consideration to the health and safety of the child and consideration to all other relevant factors needed to determine whether terminating a parent’s rights is in the child’s best interests, including whether the parent has been convicted of a “crime of violence” (which includes rape) against a minor offspring of the parent, the child, or another parent of the child or has been

convicted of conspiring or aiding the commission of these crimes. A termination of parental rights terminates the parent's duties, obligations, and rights to the child and eliminates the right of the parent to object to the adoption of the child.

Other States and Federal Law

According to NCSL, as of January 2016, approximately 34 states and the District of Columbia have enacted legislation specifically regarding the parental rights of perpetrators of sexual abuse. At least 20 of the states allow or require the complete termination of parental rights; the remaining states and the District of Columbia deny or restrict custody or visitation. Although NCSL notes that a conviction is required in many states before parental rights can be terminated, a recent federal law may prompt additional interest in the issue.

The Rape Survivor Child Custody Act, enacted in 2015 as part of the Justice for Victims of Trafficking Act, included congressional findings that (1) rape is one of the most under prosecuted serious crimes, with estimates of criminal conviction occurring in less than 5% of rapes and (2) the clear and convincing standard is the most common one for termination of parental rights. Accordingly, the law provides additional federal grant funding for states that have enacted laws to allow the mother of any child who was conceived through rape to seek court-ordered termination of the parental rights of the rapist. In order for a state to be eligible for additional federal funding, the court must be authorized to grant the termination of parental rights (the complete and final termination of the parent's right to custody of, guardianship of, visitation with, access to, and inheritance from a child) upon clear and convincing evidence of rape.

Recent Legislative Activity

The General Assembly has considered legislation in past sessions that would terminate the parental rights of a father of a child conceived through sexual violence perpetrated against the child's mother. Proponents of such legislation argue that a victim of sexual assault who becomes pregnant and chooses to have the child should not be forced into an ongoing relationship with the perpetrator of the abuse, including facing the rapist in court during any future proceedings regarding the child. Additionally, proponents assert that the rapist should not be allowed to exert control over the victim's life by having the right to object to an adoption of the child. Proponents further argue that perpetrators may attempt to coerce victims into not reporting the crime or not cooperating with law enforcement by threatening to assert parental rights over the child.

Most recently, Senate Bill 593 and House Bill 646 of the 2016 session, as introduced, would have required a court to terminate the parental rights of a respondent if the court finds that doing so is in the best interests of the child and finds by clear and convincing evidence that the respondent committed an act of nonconsensual sexual conduct that resulted in the conception of the child at issue. As in prior years, a primary area of debate was whether parental rights should be terminated without first requiring a conviction for the underlying sexual offense. The bill, as

passed by the House, incorporated numerous amendments such as requiring the Office of the Public Defender to provide legal representation to indigent respondents in the proceedings, but would not have required a conviction prior to the termination of parental rights unless the parties were married at the time of the conception of the child at issue.

The Senate Judicial Proceedings Committee also made substantial changes to the legislation such as authorizing, instead of requiring, the termination of parental rights and requiring an action to be filed within a specified time. As with the version passed by the House, the committee amendments would not have required a conviction unless the parties were married.

Courts and Civil Proceedings

Augmented Estates

Maryland and other states have examined the impact of traditional probate on a surviving spouse. As a result, these states have considered increasing the total value of estates (augmented estates) by including nonprobate as well as probate assets. In this way, the distribution may provide more financial resources for the use of the surviving spouse.

Background

In Maryland, a decedent's surviving spouse has a statutory right to elect to take a share of the net probate estate (one-third if there are one or more surviving lineal descendants or one-half if there is no surviving lineal descendant) instead of property left to the surviving spouse by will. In addition to Maryland, 39 other states also provide a right of election to a surviving spouse. Of the 10 remaining states, 9 are community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin), where property acquired with income earned during a marriage is owned jointly by both spouses. Upon the death of one spouse, the surviving spouse is entitled to one-half of the community property. One state, Kentucky, still recognizes the ancient doctrine of "dower and curtesy," under which a surviving spouse may release the property given to him or her by will and receive a one-third share of any real estate owned by the decedent.

Application of Elective Share

In 20 states, including Maryland, (Alabama, Arkansas, Connecticut, Georgia, Illinois, Indiana, Iowa, Massachusetts, Michigan, Mississippi, New Hampshire, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, and Wyoming) a surviving spouse's elective share applies to the "net probate estate," (*i.e.*, property of the decedent passing by will that is reduced by specified estate-related expenses). In these states, a surviving spouse can be effectively disinherited if most of the decedent's assets pass outside probate, for example, through joint tenancies with right of survivorship, bank or brokerage accounts with a "transferrable on death" or "payable on death" beneficiary designation, or *inter-vivos* trusts. Conversely, if the decedent has adequately provided for the surviving spouse through nonprobate assets, an election by the surviving spouse to take the statutory share of the net probate estate can result in the spouse receiving more than his or her "fair share."

The other 20 elective share states (Alaska, Colorado, Delaware, Florida, Hawaii, Kansas, Maine, Minnesota, Missouri, Montana, Nebraska, New Jersey, New York, North Carolina, North Dakota, Oregon, South Dakota, Utah, Virginia, and West Virginia) have addressed this situation by expanding the pool of assets to which the elective share applies. In these states, the

elective share applies to the “augmented estate,” which includes specified nonprobate as well as probate assets. Of these 20 states, at least 14 states’ laws are substantially similar to one of the versions of the Uniform Probate Code (UPC).

Uniform Probate Code

UPC was originally promulgated by the National Conference of Commissioners on Uniform State Laws (also known as the Uniform Law Commission (ULC)) in 1969. The concept of the augmented estate was introduced in this version of the UPC. The ULC then substantially revised provisions relating to the elective share of a surviving spouse in 1990. Reorganization and additional clarifying provisions were promulgated in 1993 and 2008.

1990s UPC

Under the 1990/1993 UPC, the surviving spouse’s elective share was determined by the length of time the decedent and surviving spouse were married to each other. For marriages of less than 1 year, the surviving spouse would be entitled to a supplemental amount only, for which the 1990/1993 UPC suggested the amount of \$50,000. For marriages of 1 year but less than 2, the elective share percentage would be 3% of the augmented estate, increasing by 3% for each year of marriage, up to a maximum of 50% for marriages of 15 years or more.

The definition of augmented estate was revised. Under this model, the augmented estate equaled the value of the couple’s combined assets, not just the value of the assets nominally titled in the decedent’s name. More specifically, the augmented estate was composed of the sum of four elements: (1) the value of the decedent’s net probate estate; (2) the value of the decedent’s nonprobate transfers to others, consisting of will-substitute-type *inter-vivos* transfers made by the decedent to others than the surviving spouse; (3) the value of the decedent’s nonprobate transfers to the surviving spouse, consisting of will-substitute-type *inter-vivos* transfers made by the decedent to the surviving spouse; and (4) the value of the surviving spouse’s net assets at the decedent’s death, plus any property that would have been in the surviving spouse’s nonprobate transfers to others had the surviving spouse been the decedent.

The 1990/1993 UPC also established the priority to be used in determining the sources from which the elective share amount was payable. The surviving spouse was not entitled to any further amount from either the decedent’s probate estate or other recipients of the decedent’s nonprobate transfers if the combined value of the following equaled or exceeded the elective share amount: (1) the amounts passing to the surviving spouse by testate or intestate succession; (2) the decedent’s nonprobate transfers to the surviving spouse; and (3) specified property of and nonprobate transfers by the surviving spouse.

According to the ULC’s General Comment to the draft, the main purpose of these revisions was “to bring elective-share law into line with the contemporary view of marriage as an economic partnership.” The comment further explained that the intent of the provisions was to ensure that

the surviving spouse was eligible for an equitable distribution of assets, even if those assets were disproportionately titled to the decedent. Conversely, another impact of the changes was to ensure an appropriate distribution if the marriage was short-term, or if neither spouse significantly contributed to the other's wealth.

2008 Revisions

The 2008 revisions to the UPC restructured the elective share percentage. Instead of basing the elective share percentage on the length of the marriage, the revised elective share became 50% of “the value of the marital property portion of the augmented estate.” The composition of the augmented estate was essentially unchanged. Under this version, the value of the marital property portion of the augmented estate consists of the values of the four components of the augmented estate described above multiplied by an increasing percentage, beginning with 3% for marriages of less than 1 year, up to 100% for marriages of 15 years or more.

Legislative Activity in Maryland

Legislation to implement the augmented estate concept in Maryland was introduced in 2012, 2014, and 2016. Senate Bill 633 of 2012 was modeled after the 2008 revisions to the elective share provisions of the UPC. The bill was heard in the Judicial Proceedings Committee, but no further action was taken. The 2014 legislation (Senate Bill 621/House Bill 570) was a pared-down version of the 2008 UPC. The Senate bill was heard in the Judicial Proceedings Committee, but no further action was taken; the House bill was withdrawn. Senate Bill 913/House Bill 1229 of 2016, drafted by the Estate and Trust Law Section of the Maryland State Bar Association, took a different approach. The bills would have defined the augmented estate as the value of the decedent's gross estate for federal estate tax purposes, which consists of the value of all property owned by a decedent or in which the decedent had an interest at the time of death, reduced by specified estate-related expenses. The surviving spouse's elective share would have been one-half or one-third of the augmented estate of the decedent (depending on whether there was a living lineal descendant of the decedent) reduced by the value of the “spousal benefits,” (*i.e.*, assets passing to the surviving spouse by reason of the decedent's death or that were held in trust for the spouse's benefit). House Bill 1229 passed the House, but no action was taken in the Senate. The Senate bill was heard, but not voted, in the Judicial Proceedings Committee.

Environment and Natural Resources

The Status of Chesapeake Bay Restoration

Maryland is approaching the 2017 midpoint assessment for Chesapeake Bay restoration and beginning the development of its Phase III Watershed Implementation Plan. Nutrient reductions from the wastewater sector, and in some states, the agricultural sector, have helped Maryland and the other bay states approach their reduction targets for phosphorus and sediment, but it appears that the target for nitrogen reductions may not be met. Meanwhile, new septic system and nutrient management regulations have been proposed, and new nutrient trading and Aligning for Growth policies are likely to be proposed soon.

Background

In December 2010, the U.S. Environmental Protection Agency (EPA) established a Chesapeake Bay Total Maximum Daily Load (TMDL), as required under the federal Clean Water Act and in response to consent decrees in the District of Columbia and Virginia. This TMDL sets the maximum amount of nutrient and sediment pollution that the bay can receive and still attain water quality standards. It also identifies specific pollution reduction requirements; all reduction measures must be in place by 2025, with measures in place to achieve at least 60% of pollution reductions relative to 2009 by 2017 – the timing of the midpoint assessment. The next phase of restoration will include the development of a Maryland Phase III Watershed Implementation Plan (WIP) that will address pollution reductions needed between 2018 and 2025.

Chesapeake Bay Restoration Status

Bay restoration is characterized by the implementation of best management practices (BMP) that reduce nutrient (nitrogen and phosphorus) and sediment loading. The results of implementing BMPs are reflected in the University of Maryland Center for Environmental Science's Chesapeake Bay Report Card (report card). The report card compares seven indicators – dissolved oxygen, nitrogen, phosphorus, chlorophyll a, water clarity, aquatic grasses, and benthic community – to scientific goals. The current status of BMP implementation and bay health is outlined below.

- **BMPs** – The modeled results from BMP implementation reflect that the bay jurisdictions are on track to attain the watershed-wide 2017 targets for phosphorus and sediment, but not for nitrogen. In fact, the nitrogen reduction is currently projected to be only 46% as opposed to the 60% reduction target. For Maryland, there appears to be a shifting of the 2017 target goals relative to last year, with the wastewater and agriculture sectors reflecting greater reductions in order to offset lesser reductions from the stormwater and septic system

sectors. EPA has noted in its most recent analysis that it may increase its oversight of Maryland's stormwater sector if Maryland does not make substantial improvements.

- **Health** – The health of the bay, as measured by the report card, has generally remained the same since 2003. The overall health of the bay improved slightly in 2015, although still receiving an overall score of C, indicating that the bay is in “moderate ecosystem health.”

Maryland Specific Actions

Maryland is embarking on the development of its Phase III WIP at the same time that it is proposing modifications to septic system and nutrient management regulations, and developing nutrient trading and Aligning for Growth (formerly Accounting for Growth) policies.

Phase III WIP

Phase III WIP implementation is broken up into three planning periods and comes with new expectations regarding the development of local area planning goals and an accounting for the impact of the Conowingo Dam and climate change on loading targets. The three Phase III WIP planning periods are as follows:

- **Expectations** – preliminary, formal, and final drafts are due to EPA between June 2016 and April 2017;
- **Planning Targets** – draft and final planning targets are due to EPA between June 2017 and December 2017; and
- **Phase III WIP Documents** – draft and final Phase III WIP documents are due to EPA between August 2018 and December 2018.

Of particular interest to local governments is the potential for the development of local area planning goals. While there is no consensus yet on exactly how these goals would work, the idea is that these goals may be adopted by any local political or programmatic entity (cities, towns, soil conservation districts, etc.) for any nonpoint source of nutrient and sediment loading in order to support implementation efforts and provide a framework for tracking progress. The focus is on nonpoint sources of pollution since point sources of pollution – wastewater treatment plants (WWTPs), some stormwater discharges, and concentrated animal feeding operations – are already governed by National Pollutant Discharge Elimination System permits. While EPA has not previously engaged at this level, EPA notes that it does not intend to take any federal actions in regard to the adoption of a local area planning goal.

Septic System Regulation

The Maryland Department of the Environment (MDE) adopted a new septic system regulation in November 2016. According to MDE, the purpose of the regulation is to remove the universal requirement that Best Available Technology for Removal of Nitrogen (BAT) systems be installed outside the Chesapeake and Atlantic Coastal Bays Critical Area (critical area) for all new construction or replacement septic systems. Under the regulation, BAT systems are still required outside of the critical area if the system has a design flow of 5,000 gallons per day or greater, or if the local jurisdiction enacts code to require BAT systems outside of the critical area in order to protect public health or the waters of the State. MDE estimates that approximately 703 fewer BAT systems may be installed annually in the State as a result of the regulation. In addition, the Administration notes that there may be an increase of approximately 50,000 pounds of nitrogen over the next 10 years.

To the extent the regulation makes it more difficult for the State and local governments to achieve and maintain the nitrogen reductions required under the TMDL, additional reductions from other sectors may be needed. For instance, according to the Maryland Department of Planning (MDP), a home utilizing a septic system causes 6 to 10 times as much nitrogen pollution as a home on public sewer and, without the current restrictions on the installation of septic systems to serve new residential development, MDP projects that future septic systems could account for three-fourths of new nitrogen pollution in Maryland over the next 25 years. On the other hand, Chapter 149 of 2012 (Sustainable Growth and Agricultural Preservation Act) could reduce the development of homes built on septic systems over time. In addition, it appears that land converted from agricultural use to another type of use will likely reduce loadings.

Nutrient Management Plan Regulations

The Maryland Department of Agriculture (MDA) proposed new nutrient management plan regulations in September 2016. The regulations alter requirements under MDA's Nutrient Management Program, applicable to regulated agricultural operations. The proposed action extends and makes statewide the annual winter deadline and prohibition for spreading nutrients to fertilize farm fields from September 10 to December 15. In addition, it removes the requirement that agricultural operations incorporate nutrients in the soil of farm fields during spring and fall applications. Lastly, it provides an emergency exception to the winter application prohibition that allows agricultural operators to spread nutrients in winter on farm fields. This last provision is intended to provide meaningful relief for dairy farms that cannot afford costs of additional nutrient storage needed to comply with current regulations. Further, it is also intended to prevent the overflow of storage structures to prevent point-source winter pollution.

Nutrient Trading

The Maryland Water Quality Trading Advisory Committee has been meeting regularly since January 2016 on the State's nutrient trading policy, which informs what is now called

Aligning for Growth. The January 2016 *Draft Maryland Trading and Offset Policy and Guidance Manual – Chesapeake Bay Watershed* has been updated with a draft September 2016 document, which reflects a greater focus on trading to meet stormwater permits.

Nutrient trading has shifted from a way to *maintain* the TMDL cap to a way to *meet* the TMDL cap. In particular, it has become a way to meet inexpensively, and perhaps temporarily, the load reductions necessary from the stormwater sector. For instance, Anne Arundel, Baltimore, Charles, Frederick, and Harford counties are proposing in their stormwater financial assurance plans, required by Chapter 124 of 2015 (Watershed Protection and Restoration Programs – Revisions), to trade with WWTPs for up to half of the needed reductions in their five-year stormwater permits. However, it remains to be seen whether these trades will include capacity credits that a WWTP may generate as a result of being under their permitted capacity or performance credits generated as a result of the WWTP treating nitrogen at 3 mg/L instead of the permitted level of 4 mg/L.

The next steps for the Administration on nutrient trading are outlined below.

- **Trading Policy Allowing Stormwater Trading** – The Administration has approved the financial assurance plans for the State’s 10 largest jurisdictions even though the jurisdictions’ Municipal Separate Storm Sewer System (MS4) stormwater permits do not currently allow for stormwater trading. Therefore, the Administration will need to do one of the following: (1) modify the MS4 permits; (2) adopt a regulation to allow stormwater trading to occur; (3) implement a compliance action such as a consent decree; or (4) wait until the next permit cycle.
- **Bay Restoration Fund Expansion** – The Bay Restoration Fund has been proposed as a means to start nutrient trading by expanding the authorized uses of the fund to include the purchase of cost-effective nitrogen and phosphorus nutrient credits (House Bill 325 of 2016; failed).
- **Aligning for Growth** – The offset of new or increased development is the goal of the Aligning for Growth policy, but the policy has many complications, including the possibility of the need for detailed site-by-site accounting of development, which would require the involvement of local stormwater planners. On the other hand, a detailed site-by-site offset evaluation process may be unnecessary if the current thinking holds that forest and agricultural land converted to urban and septic system use lowers nutrient and sediment loading. This lowering of loading partially is due to the requirement of stormwater Environmental Site Design for new development.

Environment and Natural Resources

Oyster Restoration

The oyster management and restoration plan developed by the Department of Natural Resources (DNR) in 2009 continues to guide oyster harvesting and restoration activities in Maryland. A report released by DNR in July found that many oyster sanctuaries in the State have shown progress in oyster restoration, while others showed little or no progress. Concerns remain related to the potential adjustment of oyster sanctuary boundaries, the delay of oyster restoration activities, the appropriate role of the Oyster Advisory Commission and county oyster committees, and the lack of suitable oyster shell for planting.

The Oyster Management and Restoration Plan

In response to the oyster population in the Chesapeake Bay languishing at 1% of historic levels, decreased suitable oyster habitat, and a dwindling number of harvesters, the Department of Natural Resources (DNR) unveiled a new management and restoration plan for oysters and the State's oyster industry in December 2009. The plan increased the State's network of oyster sanctuaries from 9% to 24% of the bay's remaining quality oyster bars, established oyster aquaculture leasing opportunities and related financial assistance programs, and maintained 76% of the bay's remaining quality oyster habitat for the public oyster fishery. DNR's oyster restoration activities also included the construction of artificial oyster reefs and increased production of juvenile oysters.

In 2010, DNR adopted regulations to implement the plan. The regulations expanded the scale of oyster sanctuaries, created new opportunities for oyster aquaculture, and designated areas to be maintained for the public fishery with the intent of advancing oyster restoration.

In part, the plan and implementing regulations were based on the recommendations of the Oyster Advisory Commission (OAC). Generally, OAC is required to (1) provide DNR with advice on matters related to oysters in the bay; (2) review the best possible science and recommend changes to the framework and strategies for rebuilding and managing the oyster population in the bay; (3) review the latest findings relevant to evaluating oyster restoration alternatives for the bay; (4) review any other scientific, economic, or cultural information relevant to oysters in the bay; and (5) report to the Governor and General Assembly when appropriate. OAC met earlier this year for the first time since 2014.

Sanctuary Report

When DNR adopted its oyster restoration regulations in 2010, it committed to issuing a report to evaluate the State's oyster sanctuary network after five years (and every five years thereafter). DNR's *Oyster Management Review: 2010-2015* (sanctuary report), issued in July 2016, found that many sanctuaries show progress in oyster restoration, including increased biomass and reproductive capacity, while other sanctuaries show little or no progress. The varying progress was expected, as five years is a short evaluation period for oyster restoration and restoration activity is ongoing in some sanctuaries. The sanctuary report also found that adjustments in sanctuary boundaries may be justified based on standards delineated in the report, as long as the scale of the State's oyster sanctuary network is maintained at 20% to 30% of the remaining productive habitat.

Oyster Restoration Activities

DNR, in conjunction with other federal, State, and private partners, has implemented, or is implementing, oyster restoration projects in five bay tributaries, including Harris Creek (complete), Tred Avon River (in progress), Little Choptank River (in progress), and two locations that have yet to be selected. In February 2016, the oyster restoration project on the Tred Avon River was delayed until the issuance, and review by OAC, of the sanctuary report. This delay resulted in the loss of \$1 million in federal funds for the Tred Avon project. In August 2016, after DNR issued the sanctuary report, OAC recommended that the Tred Avon project resume. OAC set several conditions for this approval including providing watermen with increased input into siting decisions for the two remaining projects; making oyster shell the priority material for, and restricting the use of stone in, reef construction; and expanding the search for local shell for oyster substrate.

County Oyster Committees

County oyster committees are established in each tidewater county in the State for each oyster harvesting gear to advise DNR on oyster propagation in the respective areas. The law governing county oyster committees is decades old and does not reflect modern realities. For instance, in some cases, there are not enough oyster harvesters in a specific county who use a particular gear to serve on the five-member committee. To this end, DNR adopted regulations during the 2015 interim to streamline and modernize the election process for county oyster committees. In addition, the General Assembly considered House Bill 758 (failed)/Senate Bill 964 (failed) in 2016, which would have further altered the membership, powers, and election process for the committees.

Oyster Shell Production

Obtaining sufficient oyster shell to plant on sanctuaries, sell for use in new and expanded lease areas, and plant on the public oyster fishery is a vital component of oyster restoration. Native oyster shell is in short supply, and out-of-state shell is expensive and, according to some stakeholders, not as effective as native shell. To this end, the initial version of House Bill 1002 (failed) considered by the General Assembly in 2015 would have allowed county oyster committees to use their State-provided funds to purchase shell for the public oyster fishery.

In addition, over the 2015 interim, DNR applied to the U.S. Army Corps of Engineers for a permit to dredge oyster shells from the Man O'War Shoals in Baltimore County, a controversial step in the minds of recreational anglers who feel that dredging will damage this productive recreational fishing ground. In August 2016, DNR submitted a revised permit application for Man O'War Shoals based on comments from State and federal agencies. In addition, OAC conditioned approval for the resumption of the Tred Avon restoration on DNR applying for additional upper bay oyster shell dredge permits and working with federal agencies and local watermen on the possible recovery of past shell plantings.

Policy Implications

Since the development of DNR's oyster management and restoration plan, the General Assembly has continued to review the progress of the plan, as well as regulatory and policy changes made to the plan. The General Assembly will continue its oversight of oyster restoration activities during the 2017 session, especially in light of new information in DNR's sanctuary report and concerns related to the potential adjustment of oyster sanctuary boundaries, the delay of oyster restoration activities, the appropriate role of OAC and county oyster committees, and the lack of suitable oyster shell for planting.

Environment and Natural Resources

Marcellus Shale: An Update on Hydraulic Fracturing in Maryland

The Maryland Department of the Environment has recently proposed regulations that address new technologies and practices, including hydraulic fracturing and horizontal drilling, for the exploration and production of oil and gas in the State. However, significant concerns remain regarding the potential impacts that hydraulic fracturing may have on public health, safety, natural resources, and the environment.

Background

Over the past decade, the development of new drilling technologies, including hydraulic fracturing and horizontal drilling, have led to a boom in domestic energy production in the United States. The Marcellus Shale formation is a geologic feature in the Appalachian Range that has attracted significant attention from the energy industry for its rich natural gas deposits. In Maryland, the formation is located in Allegany, Garrett, and Washington counties; however, the only anticipated areas of natural gas production are in Garrett and western Allegany counties.

As the use of hydraulic fracturing has increased, so has concern about its potential impacts. Exploration for and production of natural gas in nearby states have resulted in injuries, well blowouts, releases of fracturing fluids, releases of methane, spills, fires, forest fragmentation, road damage, and evidence of water contamination. The U.S. Environmental Protection Agency has also raised concerns regarding the impact of hydraulic fracturing on water supplies, water quality, and air quality.

The Maryland Department of the Environment (MDE) regulates oil and gas exploration and production in the State and has broad authority to impose conditions on permits to protect the State's natural resources and provide for public safety. Current law and regulations require a person to obtain a permit from MDE before drilling a well for the exploration, production, or underground storage of oil or gas in the State. A permit is also required for the disposal of any product of an oil or gas well.

Current regulations for oil and gas were written prior to the use of hydraulic fracturing and horizontal drilling and, as of December 2016, have not been revised since 1993. These regulations apply to all oil and gas wells in Maryland, are not specific to the practice of hydraulic fracturing and, in some cases, are incompatible with modern industry practices. Nonetheless, applications for permits to produce natural gas in Maryland using hydraulic fracturing and horizontal drilling were first filed with MDE in 2010; however, these permit applications were subsequently withdrawn.

Marcellus Shale Safe Drilling Initiative

Governor Martin J. O'Malley established the Marcellus Shale Safe Drilling Initiative by executive order in June 2011 to ensure that, if drilling for natural gas from the Marcellus Shale proceeds in Maryland, it is done in a way that protects public health, safety, natural resources, and the environment. The executive order directed MDE and the Department of Natural Resources (DNR) to assemble and consult with an advisory commission and to conduct a three-part study. The completed study includes findings and recommendations regarding (1) sources of revenue and standards of liability for damage caused by gas exploration and production; (2) best practices for gas exploration and production; and (3) the potential impacts of drilling in the Marcellus Shale formation. Ultimately, the departments concluded that the risks to public health and the environment can be adequately managed under a stringent regulatory regime that relies on the best practices identified in the report.

Regulatory Actions

MDE developed regulations to implement many of the best practices identified during the initiative, which were published in the *Maryland Register* on January 9, 2015, but were subsequently withdrawn. Meanwhile, Chapters 480 and 481 were enacted in 2015, which require MDE to adopt regulations to provide for the hydraulic fracturing of a well for the exploration or production of natural gas by October 1, 2016. Under the Acts, the regulations may not take effect until October 1, 2017. Further, a permit to drill a well using hydraulic fracturing may not be issued before October 1, 2017.

On September 26, 2016, MDE submitted to the Joint Committee on Administrative, Executive, and Legislative Review (AELR) new regulations that repeal the existing chapter on oil and gas exploration and production and replace them with more stringent provisions to address new technologies and practices, including hydraulic fracturing and horizontal drilling. Similar to the 2015 proposal, the regulations establish a suite of best practices to be followed for oil and gas exploration and production in Maryland; they are intended to protect public health, safety, natural resources, and the environment. MDE intends to publish these regulations in the *Maryland Register* on November 14, 2016, and they may be adopted as soon as January 10, 2017. It is anticipated that AELR will hold a public hearing on the regulations on December 20, 2016.

Local Actions

Due to concerns regarding air and water pollution, and the impact that hydraulic fracturing may have on the region's tourism and outdoor recreation industries, two Garrett County municipalities, the Town of Mountain Lake Park (April 2011) and the Town of Friendsville (July 2016), have adopted ordinances that effectively ban hydraulic fracturing within their borders. Additionally, in April 2016, the Prince George's County Council altered the county's zoning laws to prohibit hydraulic fracturing and related activities in the county. Although the Marcellus Shale

formation is not located in Prince George’s County, an area in the southern part of the county, Taylorsville Basin, may be an untapped natural gas reserve, according to the U.S. Geological Survey.

Policy Implications and Past Legislative Proposals

Although MDE has recently proposed new oil and gas regulations that require the industry to utilize a suite of best practices, significant concerns remain regarding whether the potential economic benefits of hydraulic fracturing outweigh the potential risks to public health, safety, natural resources, and the environment. Past legislative proposals have included (1) permanently banning hydraulic fracturing; (2) defining “hydraulic fracturing” as an ultra-hazardous and abnormally dangerous activity; and (3) requiring the disclosure of chemicals used in hydraulic fracturing.

Environment and Natural Resources

Lead Poisoning Issues

Although there has been a steady decline in childhood lead exposure over the past 20 years, lead poisoning remains a significant health issue in Maryland. Lawmakers continue to grapple with questions about how to best apportion liability in lead poisoning cases. Moreover, recent events have raised questions about the adequacy of efforts to enforce key provisions of the State's lead laws.

Lead Poisoning in Children

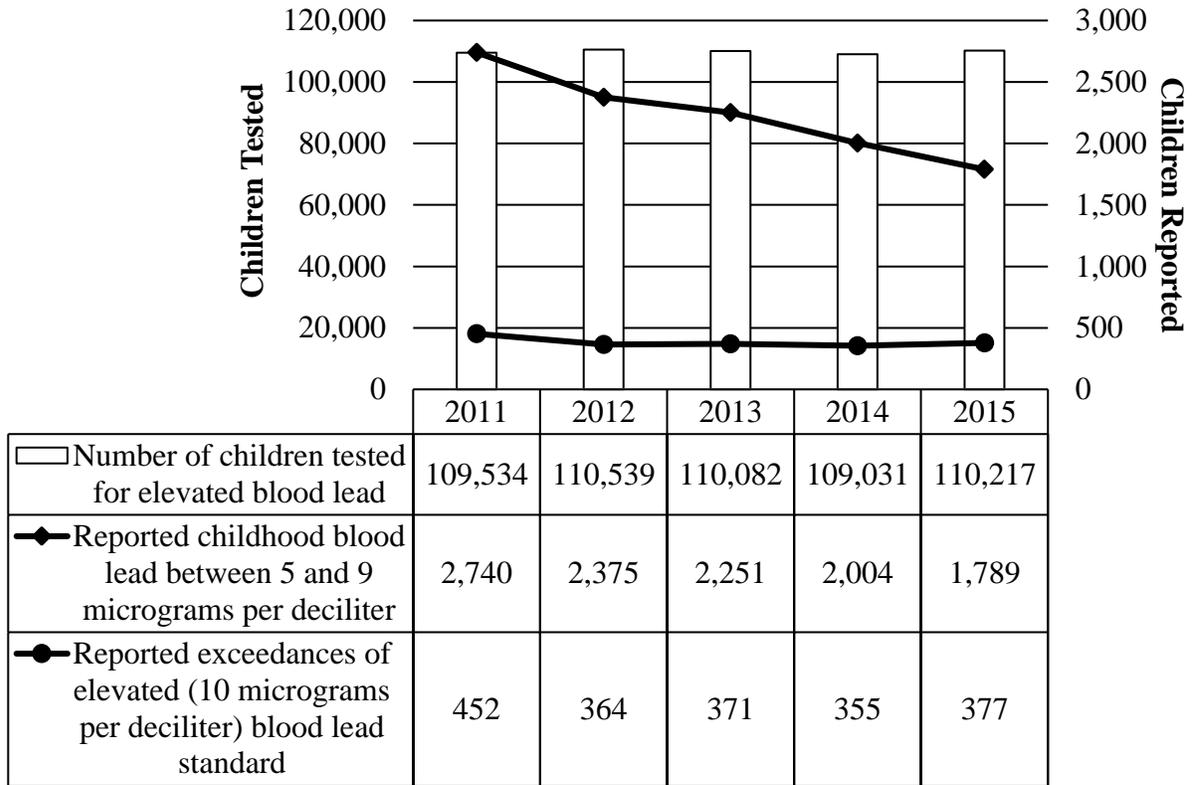
According to the U.S. Environmental Protection Agency (EPA), low level exposure to lead in childhood can cause, among other things, nervous system and kidney damage; learning disabilities, attention deficit disorder, and decreased intelligence; speech, language, and behavior problems; and hearing damage. Children younger than age six are more susceptible to the effects of lead exposure because their neurological systems are still developing. Additionally, young children are more likely to ingest lead-contaminated dust or items because children regularly engage in hand-to-mouth activity.

Lead-based paint is the major source of exposure for children in Maryland. While the use of lead-based paint has been banned in the United States since 1978, lead-based paint remains on interior and exterior surfaces of buildings constructed before 1978. Additional sources of lead exposure include soil contaminated by leaded gasoline or paint, water contaminated by plumbing with lead or lead solder, clothing contaminated with lead from the workplace, older and imported toys and other children's products with parts containing lead, and food and medicine.

Recent Trends

The Maryland Department of the Environment (MDE) provides blood lead surveillance through a registry of test results of all children tested for lead exposure in Maryland. **Exhibit 1** shows that in 2015, the most recent year for which data is available, 110,217 children younger than age six were tested out of an estimated statewide population of 535,094. In that same year, 377 children (or 0.3% of those tested) were identified as having a blood lead level of greater than 10 micrograms per deciliter, up from 355 in 2014. According to MDE, this increase can be attributed to cases involving immigrants and refugees that have recently relocated to Maryland from the Middle East and Africa. MDE findings suggest that cultural remedies, herbs, and make-up may be associated with lead exposure in the State's immigrant and refugee population. An additional 1,789 children had blood lead levels between 5 and 9 micrograms per deciliter, down from 2,004 in 2014.

**Exhibit 1
Reported Childhood Blood Lead Levels in Maryland
2011-2015**



Source: Maryland Department of the Environment

In October 2015, the State released the *Maryland Targeting Plan for Areas at Risk for Childhood Lead Poisoning*. This plan and accompanying proposed regulations call for blood lead testing at 12 and 24 months of age throughout the State (generally referred to as “universal testing”). Under this plan, all areas of the State are considered “at risk.” Previously, only children living in certain at-risk ZIP codes or who were enrolled in Medicaid were targeted for testing. Department of Health and Mental Hygiene (DHMH) regulations specify that the child’s blood lead analysis must be administered in connection with the child’s 12-month visit and 24-month visit to a health care provider.

Civil Liability for Lead Poisoning

Limited Liability Provisions Ruled Invalid

In 2011, the Maryland Court of Appeals invalidated a key provision of the Maryland Reduction of Lead Risk in Housing law (Maryland lead law), which regulates older rental properties that may contain lead paint. Previously, the law limited the liability of landlords who complied with applicable lead risk reduction standards through a “qualified offer.” Essentially, this provision limited compensation to children residing in affected rental units to not more than \$7,500 for all medically necessary treatments and to not more than \$9,500 for relocation benefits, for a total of \$17,000. However, in *Jackson v. The Dackman Company*, 422 Md. 357 (2011), the Court of Appeals ruled that the Maryland lead law’s limits on landlord liability were unconstitutional because they violated Article 19 of the Maryland Declaration of Rights.

Article 19 protects the right to a remedy for an injury and the right of access to the courts. In *Jackson*, the court stated that the test to be applied under an Article 19 challenge is whether the restriction on a judicial remedy is reasonable. The court found that the \$17,000 remedy available under the Maryland lead law was “miniscule” and, thus, not reasonable compensation for a child permanently damaged by lead poisoning. Therefore, the court held the law’s limited liability provisions to be invalid under Article 19, because a qualified offer does not provide a reasonable remedy for injuries resulting from lead poisoning. The General Assembly has not passed legislation to address this ruling, and the invalid liability provisions still appear in statute.

Market Share Liability

One issue that continues to be raised before the General Assembly is whether the manufacturers and distributors of lead paint should be liable for the health issues caused by their products under a theory of “collective” or “market share” liability. Market share liability has its origins in the California case *Sindell v. Abbott Laboratories*, 26 Cal. 3d 588 (1980). In *Sindell*, the California Supreme Court devised market share liability to allow victims of the defective miscarriage preventative diethylstilbestrol (DES) to recover for their injuries in cases where plaintiffs could not determine which particular manufacturer of DES was responsible for their injuries. The court reasoned that “between an innocent plaintiff and negligent defendants, the latter should bear the cost of the injury.” Market share liability has been applied in only a handful of cases nationwide outside of the DES context. In one such case in 2005, the Wisconsin Supreme Court extended Wisconsin’s variant of market share liability to litigation against lead-based paint manufacturers. *Thomas v. Mallett*, 701 N.W.2d 523 (Wis. 2005).

Advocates of adopting a market share liability standard for lead paint cases in Maryland argue that doing so would help to ensure adequate compensation for children with lead poisoning while helping to mitigate the liability of landlords. However, Maryland courts have generally rejected market share liability, and legislative efforts to apply theories of market share liability to lead paint cases have so far been unsuccessful.

Enforcement of Maryland’s Reduction of Lead Risk in Housing Law

The Maryland lead law establishes registration and inspection requirements for “affected properties,” aimed at minimizing the risk of lead poisoning among tenants of older buildings. As of January 1, 2015, an “affected property” is any property constructed before 1978 that contains at least one residential rental unit. Compliance with the law involves (1) registration of the property with MDE; (2) distribution of tenant educational information; (3) meeting applicable risk reduction standards; and (4) using trained or accredited workers, supervisors, and contractors for work related to meeting risk reduction standards. An affected property is exempt from the risk reduction standards if an accredited lead inspector certifies the property as “lead-free” or “limited lead-free.”

Office of Legislative Audit Findings

In its 2015 audit, the Office of Legislative Audits (OLA) raised significant concerns about MDE’s enforcement of registration and certification requirements. OLA concluded that MDE databases and policies were insufficient to ensure that all affected properties are registered and that owners with affected properties have required inspection certificates. In its response to the audit, MDE acknowledged that it does not have a process in place to compare registrations to certificates. MDE is currently working to upgrade its registration and certifications databases, which should make it easier for MDE to identify affected properties that are not in compliance with inspection and certification requirements.

Investigation of Fraudulent Lead-free Certifications

Questions have also arisen about the department’s reliance on private contractors to perform lead inspections, audits, and spot checks. On January 28, 2016, MDE announced that it had opened a joint investigation with EPA and DHMH to determine whether one particular private inspector fraudulently certified rental properties as being lead-free. The investigation was spurred by the receipt of a complaint concerning the validity of a lead-free certificate, which led to the invalidation of seven lead-free certificates issued by the private inspector.

MDE initially sent letters to residents of 384 properties that were certified lead free by the inspector between calendar 2010 and 2014. The letters encouraged residents to have the properties re-inspected and any children under the age of six taken to a physician for lead testing. In July 2016, MDE expanded their probe to include 1,600 additional properties, some of which were last inspected as far back as 1996. Between January and the end of July 2016, the State retested 80 properties and voided half of the lead-free certifications that had previously been issued, either because lead was present at the property or because the inspectors determined that portions of the property had not originally been checked. Of the 80 properties that were retested, lead was found in 33, or about 2 out of 5 properties. The investigation is ongoing, and MDE indicates that it is too early to determine whether the problem is limited to a single business, or whether there may be a larger problem within the accredited lead inspector and contractor universe.

State Government

Cybersecurity of Election Systems

In the midst of concerns voiced by multiple federal agencies that state election systems may be the target of cyberattacks designed to disrupt the 2016 elections, the State has abandoned its electronic touchscreen voting system and implemented a new paper-ballot voting system and also availed itself of cybersecurity assistance offered by federal officials for the State's electronic voter registration system and other electronic election-related infrastructure. In addition, the State Board of Elections has instituted post-election auditing procedures and implemented new electronic technology that facilitates absentee voting, though each of these two new processes, according to some experts, remains problematic.

Introduction

Cyberattacks on state voter registration databases in the months leading up to the presidential election have heightened concerns among federal officials about the security of state election systems that are connected to the Internet. Federal officials are investigating whether the actual and attempted intrusions into state voter registration databases are part of a larger Russian government campaign to influence or disrupt the national election or instead are the work of cyber criminals intent on identity theft. The Federal Bureau of Investigation (FBI) has warned states to guard against cyber threats, and the U.S. Department of Homeland Security (DHS) is providing assistance to help states improve the security of online election systems. Maryland has accepted the assistance of DHS. To further enhance the security of the election process, DHS Secretary Jeh Johnson is considering designating state election systems as “critical infrastructure.”

Maryland recently made significant changes to its election system that have security implications. To enhance security and public confidence, the State recently implemented a new paper ballot voting system and is piloting post-election tabulation audits. The audit method chosen by the State Board of Elections (SBE), however, has been criticized by computer scientists and auditing experts because it does not include a review of actual paper ballots to verify the accuracy of the electronic vote count. SBE also recently certified an online ballot marking system for use by all voters despite concerns raised by security experts that the system is vulnerable to tampering and fails to protect the secrecy of the ballot.

The Nature of the Threat

Federal officials emphasize that while there are serious cyber risks to election systems, voters should have confidence in the election process overall. It would be very difficult for hackers to actually alter the outcome of a national election, in part because the machines used to actually cast and count votes are generally not connected to the Internet. In addition, the nation's system

of decentralized election administration provides a form of protection, because to affect the result, hackers would have to compromise distinct systems in many of the 9,000 jurisdictions nationwide that play a role in conducting elections.

Experts say the primary risk to the election process from cyberattacks is the potential for disruption, disenfranchisement of some voters, and loss of public confidence in the integrity of the system. All online election systems are susceptible to distributed denial of service attacks of the kind that occurred on October 21, 2016, when unknown attackers blocked access to many major websites by flooding a company that manages Internet traffic with an overwhelming volume of traffic. Internet-connected election systems that could be vulnerable to cyberattacks include online voter registration systems, election night results reporting systems, and online absentee voting systems. If voter registration data is altered or deleted by hackers, chaos could ensue at the polls when voters whose records have been changed find they must cast a provisional ballot without knowing whether it will be counted. Election night results transmitted through the Internet could be manipulated by hackers, causing confusion and casting doubt on the outcome, because the initially reported results differ from the official results. Absentee votes transmitted through the Internet could be viewed or changed by hackers, compromising the privacy and integrity of the votes. DHS and computer scientists are most strongly opposed to electronic transmission of voted absentee ballots, a practice commonly referred to as “Internet voting.” Maryland offers online voter registration but does not allow Internet voting. Fortunately, the tightly contested 2016 general election appears to have been successfully completed without any further reports of hacker incursion into state election systems.

In addition, computer scientists have long warned that electronic voting machines that do not provide a paper record of each voter’s selections are vulnerable to tampering. Although these machines are not generally connected to the Internet, they could be manipulated to alter the vote count if a hacker gained physical access to the machines. Maryland implemented a new paper ballot voting system in 2016 that allows the electronically tabulated vote count to be verified by comparing it to the paper ballots marked by voters.

Cyberattacks and Federal Response

Hackers attempted to break into the voter registration database in Arizona in June 2016, stealing the password of a local election official but failing to obtain access to voter data. The FBI told Arizona officials that Russians were responsible for the attack. In Illinois, hackers suspected to be of foreign origin successfully breached the voter registration system in June and July 2016, gaining access to the personal information of up to 90,000 voters. No data was altered, however, and the number of affected voters was a small percentage of the total. Both attacks led to a week-long shutdown of the voter registration systems. The FBI reported in late September 2016 that hackers have attempted to penetrate voter registration databases in other states and had been “scanning” many state voter registration systems in preparation for possible attacks. According to news reports, federal officials believe that Russian hackers breached the computers of a vendor for Florida’s election system, possibly exposing voter data. Four state voter registration systems have

been successfully breached in all, according to an ABC news report. There is currently no indication that voter registration data has been manipulated in any of these incidents.

In October 2016, federal officials publicly accused Russia of stealing and publicly releasing emails from the Democratic National Committee and major U.S. political figures in an effort to interfere in the presidential election. Federal officials are investigating whether the attacks on state voter registration databases are part of a broader Russian plan to destabilize the U.S. political system by undermining confidence in the nation's leaders and the election process itself. Because the hackers were apparently intent on copying rather than changing voter registration data, however, investigators are also considering the possibility that the hackers are common criminals who sought voter data for purposes of identity theft and had no intent to affect the election. If that is the case, the hackers could be based in Russia but not connected to the Russian government.

Secretary Johnson has asserted that while he has "confidence in the overall integrity of our electoral systems," cyber threats are growing and vigilance is required. DHS is offering cybersecurity assistance to state election officials on a strictly voluntary basis in the following areas: (1) cyber hygiene scans on Internet-facing systems, such as the voter registration system and election night results reporting system; (2) risk and vulnerability assessments; (3) sharing of information on cyber incidents; (4) sharing of best practices for securing voter registration databases; and (5) security advisors deployed to individual states.

As of early November, election agencies in all but two states had accepted DHS cybersecurity assistance, including SBE. DHS is performing weekly cyber hygiene scans on SBE's websites. SBE also plans to request the other DHS services but has been informed by DHS that those services will not be available until after the general election. SBE indicates that based on the information that it has received to date, it has not been necessary to take further actions to secure the State's election systems and further notes that the State's federally certified voting system, which actually counts the votes, is never connected to the Internet. In addition, the State's voter registration database is hosted in two separate locations and is backed up nightly. Voter registration data is encrypted. Access to the database is limited and all transactions are logged and subject to regular audits.

Secretary Johnson said in August 2016 that he is considering designating state election systems as "critical infrastructure," similar to the electric power system or financial services system. DHS officials say that a critical infrastructure designation would not give federal officials power to control state election systems but rather would provide increased federal resources to help states secure their systems. However, DHS expects no decision on the critical infrastructure issue to be made until after the general election. Nonetheless, some state election officials oppose a critical infrastructure designation because they believe it is the first step toward a federal takeover of voting technology policy, an area that traditionally has been left to the states.

Maryland's Optical Scan Voting System and Post-election Audits

Voters using Maryland's new optical scan voting system fill out paper ballots that are fed into an electronic scanning machine that tabulates the votes. The new system was first deployed in the 2016 primary election, replacing the former direct recording electronic touchscreen voting system, which did not provide a paper record of votes cast. The new paper ballots provide an independent record of voter intent that may be used to conduct a post-election audit that will verify or, if necessary, correct the electronic vote count, thereby providing an additional safeguard against error or fraudulent manipulation of votes. The General Assembly adopted budget language in the 2016 session requiring SBE to conduct a post-election tabulation audit following the 2016 general election utilizing the paper ballots or electronic images of the paper ballots. (The scanning machines capture an electronic image of each paper ballot as it passes through the scanner.) A report describing the audit is due to the General Assembly by December 31, 2016.

On October 19, 2016, the Board of Public Works approved a \$275,000 contract for Clear Ballot Group, Inc. to conduct a post-election audit of the 2016 general election by using its proprietary software to retabulate electronic images of all the votes cast in the election and compare those results to the results produced by the scanners. SBE indicates that this "automated" audit is less labor intensive and less subject to human error than audit methods that rely on physical handling of actual paper ballots. At the SBE meeting on October 28, 2016, a group of computer scientists and auditing experts from across the country submitted testimony stating that the proposed retabulation of electronic ballot images is not a true audit, because it is not independent of the voting system since the electronic ballot images captured by the voting system's scanners could differ from the actual paper ballots due to scanner error or intentional manipulation of the data. The experts instead recommended that a statistical sample of actual paper ballots be examined and used to audit the vote count produced by the voting system, as is done in other states that have paper ballot voting systems.

Maryland's Online Absentee Ballot System

Under legislation enacted in 2013, the State allows any absentee voter the option to request to receive a blank ballot by email or fax (in addition to the traditional option of receiving the ballot by mail). SBE staff also developed an online ballot marking tool that allows an absentee voter to mark a ballot on his or her computer screen. All absentee ballots that are sent or marked electronically must be printed out and mailed to the local board of elections office to be counted; Maryland law does not allow voted ballots to be returned electronically (Internet voting). The online ballot marking tool is designed to reduce voter errors in marking the ballot and eliminate the need for local boards to duplicate ballots manually that were sent to voters electronically onto paper that then can be fed into scanning machines. The 2013 law authorizes SBE to deploy the marking tool if four of the five members of SBE vote to certify that the online ballot marking tool satisfies certain requirements, including security and privacy. Until this year, there were not enough SBE votes to certify the tool, due primarily to the concerns of some board members about its security. However, voters with disabilities, who may need the assistance of a computer to mark

a paper ballot privately and independently, gained access to the tool in 2014 through a federal lawsuit filed by the National Federation of the Blind.

On September 14, 2016, four members of SBE voted to certify the online ballot marking tool, making it available to all absentee voters for the first time in the 2016 general election. The board overruled objections by computer scientists and security experts who claimed that the tool is vulnerable to fraud and jeopardizes voter privacy. Specifically, opponents of the tool warned that an attacker could fraudulently request and vote absentee ballots on a large scale by using stolen personal information of registered voters, noting, for example, that a great deal of individual personal information has been stolen in recent hacks of computer databases, such as the federal Office of Personnel Management. They asserted that additional information should be required when an absentee ballot is requested online to prove that the requester is who they claim to be.

In addition, opponents of the tool said that ballots marked on a voter's computer could be copied and transmitted to a third party without the voter's knowledge. This threat to ballot secrecy exists on computers subject to monitoring, such as in a workplace, or on a voter's own private computer if it is infected with malware, as computers frequently are. Further, the tool transmits the voter's selections through the Internet to SBE's servers, thereby risking the privacy of the votes, although the voter's selections are not saved on SBE's servers, and only the ballot mailed in by the voter is counted. Transmission of voter selections through the Internet violates nonbinding guidelines endorsed by the National Institute of Standards and Technology, a federal agency that assists in developing voluntary standards for voting systems.

Board members who voted to certify the online ballot marking tool stated that they had confidence that SBE's information technology staff and contractors had thoroughly tested the tool and made it as secure as possible. Among other measures, the system is continuously monitored for any suspicious activity. Board members also stated that it is not reasonable to expect any system connected to the Internet to be entirely secure.

State Government

Cybersecurity of Personal Data Maintained by State Agencies and Activities of State Groups that Monitor Cybersecurity

The Department of Information Technology (DoIT) has developed cybersecurity policies, procedures, and standards for the State. Further, DoIT has implemented strategic programs and is monitoring efforts through performance measures. The Joint Committee on Cybersecurity, Information Technology, and Biotechnology met in November 2016 to hear about cybersecurity defense. The Maryland Cybersecurity Council has ongoing meetings to develop comprehensive cybersecurity strategies.

Cybersecurity is a major concern for the State. The media is routinely reporting cybersecurity breaches, while many incidents are unreported. In recent years, the State has made efforts to identify weaknesses and make improvements. These include providing additional resources to the Department of Information Technology (DoIT); monitoring DoIT's effectiveness; requiring that DoIT provide data concerning its cybersecurity efforts; having the Joint Committee on Cybersecurity, Information Technology, and Biotechnology conduct a hearing to review State practices; and creating the Maryland Cybersecurity Council.

Activities of the Department of Information Technology

State agencies maintain substantial amounts of data related to the citizens of Maryland. Much of this data is personally identifiable information (PII). Though some PII is not sensitive, much of the PII data maintained by the State is sensitive. For example, the Comptroller's Office keeps Social Security numbers, income, and tax data, and the Department of Health and Mental Hygiene keeps medical records. It is critical that sensitive data is kept safe.

DoIT is responsible for developing, maintaining, revising, and enforcing information technology (IT) policies, procedures, and standards. This includes cybersecurity policies, procedures, and standards. In recognizing the importance of data security, DoIT's security policies provide guidance for securing confidential information, which is defined as nonpublic information that, if disclosed, would result in a highly negative impact on Maryland, its employees, or its citizens and may include information deemed as private, privileged, or sensitive. The goal is to avoid data breaches whereby confidential information is compromised.

Efforts to Provide More Resources and Accountability

In September 2012, the Office of Legislative Audits (OLA) released the *Information System Data Security* audit, which uncovered a number of security problems. In summer 2013, the Governor created a statewide Director of Cybersecurity. The director created a statewide cybersecurity advisory forum comprised of a dozen chief information officers from small,

medium, and large agencies to review policies and assist with security matters across State government. One recent product of this group is the implementation of a systematic framework on how to classify and when to report cybersecurity incidents. As part of the summer 2013 agency IT master planning process, an annex was created to require agencies to self-assess their compliance, with evidence, to State security controls as delineated in policies. The information gathered was compiled and assessed by the director, thereby allowing agencies to be measured against overall compliance to policies as well as against each other. The compiled information served as a baseline exercise.

Recognizing that the insider threat is the most prevalent cyber risk in State government, the State implemented a monthly modularized cybersecurity training and awareness program in September 2013 for all Executive Branch employees. DoIT's Managing for Results (MFR) indicator shows that 90% of employees are compliant with this training.

The Administration is also enhancing cybersecurity efforts. In its fiscal 2016 strategic plan, DoIT lists cybersecurity as its first strategic goal. DoIT adopted performance measures, including one that doubles the number of firewalls through the use of security as service contracts. DoIT also developed the following strategies:

- establish a cybersecurity office;
- restructure the agency chief information model so that DoIT has authority over strategic direction of IT implementations;
- establish risk-based policies and procedures that prioritize controls, assess risks, track mitigation, and adapt to changing threats;
- establish enterprise visibility into statewide IT assets, systems, capabilities, and data;
- establish enterprise risk and security assessments, incident response, and reporting capabilities; and
- collaborate with industry leaders and partner with commercial vendors to deliver products and services.

Recognizing the importance of keeping software and hardware up to date, the Administration requested a \$2.5 million deficiency appropriation for IT upgrades in the fiscal 2016 Reserve Fund budget. This appropriation is to be used to replace hardware, mostly personal computers and servers, in approximately 20 agencies. Most of the equipment is six to nine years old. Approved by the General Assembly, the appropriation funds will be matched by agency funds. In fiscal 2016, DoIT spent approximately \$731,000, and agencies spent another \$1,683,000 to support this initiative. DoIT expects to spend the remaining funds in fiscal 2017.

The legislature’s budget committees also appreciate the importance of cybersecurity and expect the Administration to be transparent and accountable. In the 2014 *Joint Chairmen’s Report*, DoIT was asked to develop MFR cybersecurity indicators. In its MFR submission, DoIT added the goal that it “provide leadership and support to state agencies in the areas of cybersecurity policy, risk and vulnerability assessment, technology implementation, awareness training and incident response.” As requested, DoIT also added five performance measures. **Exhibit 1** shows the initial measures and the targets from fiscal 2015 to 2017.

Exhibit 1
Cybersecurity Performance Indicators
Fiscal 2015-2017

	Actual 2015	Est. 2016	Est. 2017
Employees Compliant with Cybersecurity Awareness Training Program	90%	90%	90%
Agencies with Vulnerability Assessment, Penetration Test, or Audit	20	20	18
Certified Security Information Professionals Employed by the State	1	1	1

Source: Department of Information Technology, January 2016

Recent Audit Findings

In spite of the added performance measures, data security problems have been identified in audits. From January 2015 to January 2016, OLA identified data security problems in 16 different agencies. Agencies with three or more audit findings relating to cybersecurity issues are the Office of the Secretary in the Department of Health and Mental Hygiene, the Comptroller’s Information Technology Division, the Health Benefits Exchange, Salisbury University, the State Lottery and Gaming Control Agency, the Department of State Police, and the Department of Public Safety and Correctional Services’ Information Technology and Communications Division.

As shown in **Exhibit 2**, the kinds of audit findings include insufficient password controls, employees with unnecessary access, not updating software, not using anti-malware software, insufficient firewall protections, and intrusion detection preventions system problems.

Although DoIT increased the resources it dedicates to cybersecurity efforts, audit data show that there are still vulnerabilities. The Department of Legislative Services will continue to monitor DoIT’s efforts to improve cybersecurity and report about these efforts to the General Assembly.

Exhibit 2
Number of Audit Instances by Type of Audit Finding
January 2015-January 2016

<u>Type of Audit Finding</u>	<u>Instances</u>
Personal Identifiable Information	8
Log or Monitor Security Events	7
Firewall	5
Intrusion Detection Prevention System Problems	4
Virtual Private Network Access Problems	1
Windows XP Still Used	1
Administration Rights ¹	6
Software Not Updated	5
Service Organization Controls Review Not Performed or Obtained	2
Password Controls	4
Unnecessary User/File Access	10
Excessive Network Level Access	2
Backup Files Problems	1
Disaster Recovery Plan	1
Anti-malware	5
Data Loss Prevention	1

¹ Users had unnecessary administrative rights on their local computers.

Source: Office of Legislative Audits, February 2016

Activities of the Joint Committee on Cybersecurity, Information Technology, and Biotechnology

The Joint Committee on Cybersecurity, Information Technology, and Biotechnology originated as the Joint Technology Oversight Committee in 2000. Its duties have since been expanded to explore issues related to biotechnology in 2009 and again in 2014 when it was expanded to consider cybersecurity issues. The committee consists of 12 members: 6 senators and 6 delegates. To advance cybersecurity in Maryland, the committee evaluates State cybersecurity systems and the adequacy of economic development and job skills training programs. It works to increase knowledge, awareness, and support of advances in cybersecurity, IT, and biotechnology and also recommends actions to promote those industries in the State.

At the committee's meeting on November 10, 2016, DoIT reported that it has adopted a preparedness plan for the State. The plan includes the roles and responsibilities of State agencies and officials in the event of a large-scale or persistent cyber event. DoIT is also participating with federal- and State-level emergency management entities. Finally, DoIT briefed the committee on the Security Operations Incident Response Plan and the Security Operations Concept of Operations Plan. These plans will outline the day-to-day operations related to the State's cybersecurity issues.

Activities of the Maryland Cybersecurity Council

In 2015, the General Assembly established the Maryland Cybersecurity Council to develop comprehensive strategies and recommendations to protect the State's critical infrastructure and secure Maryland as a hub of cybersecurity innovation and jobs. The council must work with the National Institute of Standards and Technology (NIST), as well as other federal agencies, private-sector businesses, and private cybersecurity experts to recommend a comprehensive State strategic plan to ensure a coordinated and adaptable response to and recovery from cybersecurity attacks and achieve other specified goals. The council consists of up to 44 members, including several Executive department secretaries and directors (or their designees), 2 delegates, and 2 senators, as well as representatives from businesses and higher education institutions around the State. The Attorney General chairs the council and may invite federal agency representatives as appropriate. The 2 federal members are representatives of the National Security Agency and NIST.

To achieve its mission and purpose, the council established subcommittees around six main areas: (1) law, policy, and legislation; (2) cyber operations and incident response; (3) critical infrastructure and cybersecurity framework; (4) education and workforce development; (5) economic development; and (6) public awareness and community outreach. The council has met four times and issued a preliminary report in July 2016. The report proposed 17 recommendations to improve the cybersecurity of critical infrastructure entities and advance cyber innovation and jobs in Maryland. Of these recommendations, 6 focused on making legislative and policy changes, and 6 focused on increasing the resources available to educational institutions and strengthening the pipeline of people interested in cybersecurity. The council and its subcommittees continue to meet to discuss strategies to make the State the leader in cybersecurity jobs and best practices.

State Government

Public Financing of Elections – An Overview of Funding Options

Public financing for State and local elections has gained more traction in Maryland and in other jurisdictions around the country as an ever-deepening pool of private money flows into election campaigns. How to fund public financing programs, however, remains a central focus and challenge.

Current Revenue Cannot Support Multiple Gubernatorial Election Cycles

The Fair Campaign Financing Fund (FCFF) established in 1974 supports the gubernatorial public campaign financing program in the State. Most recently, disbursements from the fund totaling \$3.7 million were made to qualifying candidates in the 2014 gubernatorial election. After that election, the FCFF balance had shrunk to approximately \$1.1 million.

As currently constructed, the FCFF does not receive enough revenue to quickly replenish its balance after an election in which disbursements are made to qualifying candidates. Prior to 2010, the FCFF was funded through an income tax checkoff and received annual contributions of about \$100,000. However, following years of nonuse, the General Assembly began to authorize use of money in the fund for other election-related purposes beginning in 2009, and Chapter 484 of 2010 repealed the income tax checkoff.

After a five-year period with no dedicated revenue source, Chapter 312 of 2015 re-established an income tax checkoff for the FCFF and directed revenue to the fund from various fines/fees/penalties under the election and ethics laws, public donations, anonymous private campaign contributions, and donated surplus private campaign funds. In fiscal 2016, the FCFF received \$212,000. While that amount exceeds the average annual revenue the fund received under the pre-2010 checkoff, it is still not enough to assure that sufficient money will be available to support qualifying candidates in the next gubernatorial election in 2018. To address the FCFF fund balance, the fiscal 2017 budget includes a \$1.0 million appropriation to replenish the fund for money disbursed over the years for other election-related purposes. However, additional funds included in the Governor's allowance to replenish the FCFF for the disbursements to qualifying candidates in the 2014 gubernatorial election were cut from the budget out of concern that their inclusion would signal an ongoing commitment of general funds for the FCFF. As a result of the fiscal 2017 budget infusion and accrued interest, the current FCFF balance is \$2.4 million.

Sources of Revenue

Revenue sources that have been proposed in Maryland or utilized in other states for the most part appear to fall into one of three broad categories: (1) existing government funding (*e.g.*, general fund appropriations, income tax checkoffs that redirect tax revenue to public

campaign financing, election law penalties/fines, and abandoned property revenue); (2) donations (*e.g.*, income tax checkoffs that allow taxpayers to donate a portion of their refund or additional money, as well as website donations); and (3) newly created surcharges added to existing penalties for violations of civil or criminal laws.

Existing Government Funding

General Fund Appropriations and Income Tax Checkoffs

While most public financing programs have more than one funding source, the majority of states fund their programs with either general funds or an income tax checkoff that redirects tax revenue. This type of income tax checkoff is the primary revenue source in four states (Hawaii, Massachusetts, Minnesota, and Rhode Island), and appropriations from the state's general fund are the primary source in at least three states (Florida, Maine, and Vermont), while Michigan matches the income tax checkoff with a general fund appropriation. A 2016 ballot measure approved in South Dakota established a public campaign financing program in that state that also would be funded primarily through the state's general fund.

Pursuant to recent law authorizing county public campaign financing programs in Maryland, Montgomery County is implementing a program for local elections that is funded through county general funds. Meanwhile, Howard County voters adopted a ballot measure at the general election to establish a public campaign financing program that also likely will be funded at least partially through county general funds.

Redirected Revenue from Other Sources

Both Connecticut and New Mexico collect a majority of their public campaign financing programs' money from the sale of abandoned property. In the most recent years with available data, Connecticut's fund received \$15 million and New Mexico's fund received \$1.2 million. West Virginia funds its program through a \$400,000 mandated appropriation from rebates from its statewide purchasing card program.

The use of abandoned property revenue also has been proposed to fund public campaign financing in Maryland. Under House Bill 1353 of 2009, abandoned property revenue would have provided an estimated \$7.5 million annually for public financing for General Assembly candidates.

Donations and Surcharges

Maryland's income tax checkoff also allows taxpayers to donate any amount of money to the FCFF in addition to their tax liability. As noted previously, in past years the revenue from this source has not proven sufficient to fund a robust public financing system.

Arizona's Clean Elections Fund collects a 10% surcharge on civil and criminal penalties, which in 2014 totaled \$8.4 million. A similar funding method was considered in Maryland during

the 2010 legislative session, whereby a surcharge on drug- and alcohol-related driving offenses, under Senate Bill 681, would have generated an estimated \$506,600 in annual revenue.

State Government

Election Administration

In the 2016 primary election, the State debuted its new paper-based optical scan voting system to replace the prior electronic touchscreen voting system. Though the rollout was largely successful, some jurisdictions experienced problems, primarily due to an insufficient number of well-trained election judges, the handling and counting of provisional ballots, shortage of voting equipment, and technical limitations of some of the equipment. Against this backdrop, State and local election officials undertook steps to make improvements for the 2016 general election.

Although the rollout of the State's new paper-based optical scan voting system in the April 2016 primary to replace the prior electronic touchscreen voting system was largely successful, some problems did arise, primarily involving the improper scanning and counting of provisional ballots as regular ballots, election judge staffing shortages and inadequate election judge training, and miscellaneous logistical and technical issues concerning the voting equipment. After the primary election experience, State and local elections officials undertook steps to address the problems encountered in the primary and to prepare for the much higher voter turnout expected for the November 2016 general election. The general election ran relatively smoothly, but there were reports of some problems, including long lines. The problems had yet to be fully analyzed by election officials as of mid-November.

Provisional Ballots

Provisional ballots are provided to voters at an early voting center or polling place who cannot be checked in to vote a regular ballot because of an issue with the voter's registration or for some other reason. The provisional ballots are then reviewed by election officials after Election Day to determine whether the voter was in fact eligible to vote on any or all of the races/questions on the ballot, and any votes that the voter was eligible to cast are then counted.

In previous elections with the electronic touchscreen voting system, regular and provisional ballots were cast in different ways, with regular ballots cast on touchscreen voting machines and provisional ballots cast by filling out a paper ballot that was then set aside for later review by election officials. With the touchscreen voting system, no voting machine that scans paper ballots was in the polling place. However, with the new optical scan voting system, provisional and regular ballots are cast in a similar manner (filling out a paper ballot in both cases), thus creating the possibility that if sufficient procedures are not in place and followed, a provisional voter's ballot could be scanned into a voting machine at the poll on Election Day and counted rather than being set aside. Indeed, in the 2016 primary, most notably in Baltimore City, but also to a lesser extent in a few other counties, a relatively small number of provisional ballots were scanned into voting machines at polling places on Election Day. Fortunately, the State Board of Elections

(SBE) determined after analyzing the election results and polling place data that the improperly cast provisional ballots could not have affected the outcome of any race in the election.

To prepare for the 2016 general election, the State Administrator of Elections established a committee of local election officials to develop recommendations for actions that local boards of elections could take to ensure that no provisional ballots would be cast as regular ballots. Based on the committee's recommendations, the State Administrator established mandatory and optional actions for local boards to take during the general election, including guidance on the layout of the polling place (with separate provisional voting and regular voting areas), election judge monitoring and cognizance of provisional voters, and changes to the ballot privacy sleeve issued to provisional voters that visually distinguishes provisional voters from regular voters and ensures that provisional ballots are not scanned at polling places. SBE also created a provisional voting instructional video for election judges and voters and posted it on the SBE website.

Other Issues/Modifications

After experiencing election judge staffing and performance problems in the 2016 primary election, the Baltimore City Board of Elections undertook strategies to make improvements for the November 2016 general election, including the following: recruiting an additional 800 election judges for the general election; identifying causes of the staff deficiencies encountered at polling places at the primary election; development of a recruitment postcard; procedures to confirm that election judges who served in the primary election would serve in the general election; and follow-up surveys of the election judges who worked in polling places that experienced problems during the primary to determine where improvements could be made in training.

Moreover, SBE required the local boards of elections to cover certain topics in their training prior to the general election, including reviewing the provisional voting process with all election judges to ensure that provisional voters do not leave the provisional voting area, ensuring that ballot marking devices (which provide accessibility to voters with disabilities) are properly set up and ready for use at all times, and maintaining the secrecy of a voter's ballot as it is scanned into a voting machine.

Prior to the general election, in anticipation of the higher turnout that would be experienced in that election as compared to the primary election, additional voting equipment also was obtained by many of the local boards to supplement their existing inventory. Meanwhile, a concern was raised by at least one local board that in polling places with only one voting machine to scan paper ballots, if a voting machine has a technical problem and either has to be taken out of service temporarily to be fixed or replaced, voters can feel uneasy about having to vote and leave the polling place without seeing their ballot scanned (though it would be scanned by election officials later). At its meeting on August 17, the Board of Public Works approved \$525,000 in funding for additional scanners with the cost split evenly between the State and the counties. The minimum number of scanners per precinct was determined by the State Administrator in accordance with a formula based on the number of registered voters in a precinct. However, decisions on how to deploy the extra scanners were made by the local boards. The additional equipment was not

sufficient to provide two scanners per precinct statewide. Montgomery County opted to deploy at least two scanners in nearly all precincts, and some other counties deployed multiple scanners in some larger precincts.

Finally, an issue with the ballot marking devices that was discovered prior to the primary election could not be fixed in time for the general election. Currently, contests with large numbers of candidates are displayed on multiple screens on the ballot marking device, and options given to voters to navigate between the screens have the potential to confuse or create difficulty for a voter when the voter is making a selection and/or might otherwise influence the voter's selection.

State Government

Reorganization of State Procurement

Drawing on ideas for procurement reform put forward in 2012 as a result of a review conducted by Treya Partners and a subsequent 2014 procurement study completed by the Department of Legislative Services, the Governor's Commission to Modernize State Procurement has developed a preliminary set of proposals to overhaul the governance of State procurement, including the establishment of a Chief State Procurement Officer within the Governor's Office to oversee procurement among all State agencies.

Governor Establishes Commission on Procurement Modernization

In February 2016, Governor Hogan issued an executive order establishing a Commission to Modernize State Procurement, chaired by the Lieutenant Governor. The commission was charged with conducting a comprehensive review of the State's procurement code and regulations and making recommendations to the Governor in as many as 16 different areas, including:

- developing a statewide procurement manual and training curriculum;
- addressing impediments to attracting and retaining high-quality procurement staff;
- simplifying the Request for Proposals template and minority business enterprise certification process;
- raising the small procurement limit; and
- expanding the Small Business Reserve program.

The Governor's commission followed on the work conducted by the Department of Legislative Services (DLS) during the 2014 interim, when it conducted a review of procurement structures, policies, and practices in Maryland that itself was intended to build upon a review conducted in 2012 by Treya Partners under the direction of the Board of Public Works (BPW).

The DLS review examined the current condition of State procurement, described reforms undertaken by other states, and provided policy recommendations to enhance the cost effectiveness, efficiency, and transparency of State procurement. DLS concurred with many of Treya Partners' findings and concluded that Maryland would benefit from the types of reforms implemented in other states, adapted to the State's unique conditions. Implementation of these reforms, however, would be hampered by a fragmented system and inadequate human resource development. To address the fragmented system, DLS recommended establishing the position of Chief Procurement Officer (CPO) within BPW to report directly to the board and carry out the

board's procurement control functions. Within this structure, the CPO was expected to carry out several key functions, including:

- controlling and overseeing all State procurements by agencies that are subject to State procurement law;
- ensuring that procurement policies, procedures, and forms are the most advanced available;
- delegating control of procurement activity to units with expertise in specified types of procurement, while retaining oversight;
- developing performance metrics for State procurement;
- implementing strategic sourcing when appropriate;
- managing eMaryland Marketplace (eMM); and
- employing staff in accordance with the State budget.

The DLS report noted that Maryland is one of only a handful of states that lacks a CPO, which has hampered its ability to institute meaningful procurement reform that maximizes the State's buying power. Further, fragmented oversight of procurement by multiple control agencies has resulted in conflicting or inconsistent interpretation of procurement policies and procedures, inadequate data on State spending patterns, insufficient oversight and management of contracts, and poor relationships with State vendors. The DLS report concluded that consolidating procurement control under one office should enhance coordination, efficiency, transparency, and vendor satisfaction.

House Bill 698 of 2015 and House Bill 353 of 2016 each incorporated the DLS recommendations. House Bill 698 was withdrawn in an effort to develop a consensus for procurement reform among stakeholders, which was not achieved. House Bill 353 was similarly withdrawn pending the findings and recommendations of the Governor's commission.

Many Preliminary Recommendations Reflect Earlier Findings

Although the commission has not issued its final recommendations, it has developed a preliminary set of proposals to be voted on by the full commission prior to the December 1, 2016 due date. Many of these preliminary proposals reflect the ideas put forth by both the Treya Partners and DLS reports, although some are new ideas. Among the proposals that draw from earlier reports are:

- establish a CPO within the Governor's Office (rather than BPW) to oversee procurement among State agencies, manage eMM, and perform other related functions;

- develop and update a statewide procurement manual and corresponding training curriculum;
- upgrade the functionality and user-friendliness of eMM;
- raise the cap for small procurements from \$25,000 to \$50,000;
- implement a career track for procurement staff that includes consistent titles and uniform compensation across agencies; and
- simplify and streamline reporting requirements.

In addition, the commission's preliminary proposals include several ideas that have not been previously considered, including:

- expand the Small Business Reserve (SBR) program to double the number of current participating agencies and only count contract awards made under the SBR program toward the SBR program goal of 10% (currently, any award made to a qualified small business counts toward the goal);
- establish a task force to study limiting procurement exemptions for State postsecondary institutions;
- simplify the standard Request for Proposals template and minimize the documents that must be submitted in response to a State solicitation; and
- streamline the application process for Minority Business Enterprise program certification.

Some of these recommendations can be accomplished administratively, but others require statutory changes. At the commission's November 2, 2016 meeting, the Lieutenant Governor indicated that no decision has been made regarding the process for introducing necessary legislation.

Local Government

State Aid to Local Governments

State aid to local governments is projected to total \$7.5 billion in fiscal 2018, representing a \$195.5 million or 2.7% increase over the prior year.

Local governments are projected to receive \$7.5 billion in State aid in fiscal 2018, representing a \$195.5 million, or 2.7%, increase over the prior year. Most of the State aid in fiscal 2018, as in prior years, is targeted to public schools, while funding for counties and municipalities will account for 8.8% of total State aid. Public schools will receive \$6.4 billion in fiscal 2018, 85.2% of total State aid. Counties and municipalities will receive \$667.9 million, community colleges will receive \$321.0 million, libraries will receive \$78.3 million, and local health departments will receive \$53.4 million. In terms of year-over-year funding enhancements, State aid for public schools will increase by \$116.0 million (1.8%); library aid will increase by \$4.3 million (5.7%); community college aid will increase by \$6.7 million (2.1%); and local health department grants will increase by \$3.9 million (7.9%). Also, county and municipal governments will realize a \$64.7 million (10.7%) increase in State aid. **Exhibit 1** shows the change in State aid by governmental entity for fiscal 2018. **Exhibit 2** shows the change in State aid by major programs.

Exhibit 1 State Aid to Local Governments (\$ in Millions)

<u>Governmental Entity</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>\$ Change</u>	<u>% Change</u>
Public Schools	\$6,310.2	\$6,426.2	\$116.0	1.8%
County/Municipal	603.2	667.9	64.7	10.7%
Community Colleges	314.3	321.0	6.7	2.1%
Libraries	74.0	78.3	4.3	5.7%
Local Health Departments	49.5	53.4	3.9	7.9%
Total	\$7,351.2	\$7,546.8	\$195.5	2.7%

Source: Department of Legislative Services

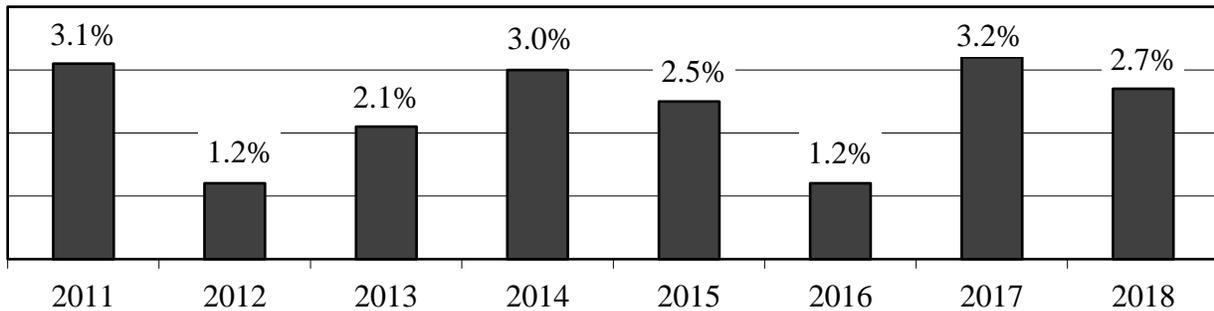
Exhibit 2
State Aid by Major Programs
Fiscal 2016-2018
(\$ in Millions)

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018 Baseline</u>	<u>FY 2017-2018 \$ Change</u>	<u>FY 2017-2018 % Change</u>
Public Schools					
Foundation Program	\$2,947.1	\$2,962.0	\$3,006.3	\$44.3	1.5%
Supplemental Grant	46.6	46.6	46.6	0.0	0.0%
Geographic Cost Index	68.1	136.9	139.1	2.2	1.6%
Net Taxable Income Education Grants	23.8	39.7	50.9	11.2	28.2%
Foundation – Special Grants	0.1	19.4	0.0	-19.4	-100.0%
Compensatory Aid	1,305.1	1,309.1	1,362.2	53.1	4.1%
Student Transportation	266.2	270.8	275.7	4.9	1.8%
Special Education – Formula Aid	276.0	279.6	283.8	4.2	1.5%
Special Education – Nonpublic Placements	130.5	126.6	126.1	-0.5	-0.4%
Limited English Proficiency Grants	217.2	227.0	246.1	19.1	8.4%
Guaranteed Tax Base	53.8	54.5	52.1	-2.4	-4.5%
Aging Schools Program	6.1	0.0	6.1	6.1	
Head Start/Pre-kindergarten	6.1	6.1	9.8	3.7	60.2%
Other Education Programs	74.4	64.5	85.1	20.6	31.9%
Subtotal Direct Aid	\$5,421.1	\$5,543.0	\$5,689.8	\$146.9	2.6%
Retirement Payments	\$729.3	\$767.3	\$736.4	-\$30.9	-4.0%
Total Public School Aid	\$6,150.4	\$6,310.2	\$6,426.2	\$116.0	1.8%
Libraries					
Library Aid Formula	\$35.4	\$36.4	\$40.7	\$4.3	11.9%
State Library Network	16.6	17.0	17.7	0.7	4.1%
Subtotal Direct Aid	\$52.0	\$53.4	\$58.4	\$5.0	9.4%
Retirement Payments	\$19.7	\$20.7	\$19.9	-\$0.8	-3.7%
Total Library Aid	\$71.7	\$74.0	\$78.3	\$4.3	5.7%
Community Colleges					
Community College Formula	\$222.7	\$234.4	\$242.3	\$7.9	3.4%
Other Programs	31.4	33.5	34.0	0.5	1.6%
Subtotal Direct Aid	\$254.1	\$267.9	\$276.3	\$8.4	3.2%
Retirement Payments	\$42.0	\$46.5	\$44.7	-\$1.7	-3.8%
Total Community College Aid	\$296.1	\$314.3	\$321.0	\$6.7	2.1%
Local Health Grants	\$45.7	\$49.5	\$53.4	\$3.9	7.9%
County/Municipal Aid					
Transportation	\$201.5	\$209.6	\$212.0	\$2.3	1.1%
Public Safety	117.9	126.7	129.9	3.2	2.6%
Program Open Space	23.5	27.2	40.7	13.5	49.7%
Disparity Grant	129.8	132.8	147.7	14.9	11.2%
Gaming Impact Grants	38.6	62.9	93.0	30.2	48.0%
Teacher Retirement Supplemental Grant	27.7	27.7	27.7	0.0	0.0%
Other Grants	17.4	16.3	16.9	0.6	3.8%
Total County/Municipal Aid	\$556.3	\$603.2	\$667.9	\$64.7	10.7%
Total State Aid	\$7,120.2	\$7,351.2	\$7,546.8	\$195.5	2.7%

Source: Department of Legislative Services

Exhibit 3 shows the annual change in State aid to local governments, beginning with fiscal 2011. The projected growth of 2.7%, or \$195.5 million, in fiscal 2018 is well within the range of annual growth exhibited in recent years. This reflects a \$229.0 million (3.5%) increase in direct aid to local governments being partially offset by a \$33.4 million (4.0%) decrease in State retirement aid for local government employees. Most of the net growth is accounted for by an estimated \$146.9 million increase in direct State aid to public schools. Growth in the foundation program and the compensatory aid program drive much of this increase. The State’s foundation program for public schools increases by an estimated \$44.3 million (1.5%). The increase is attributable to the rise in the per pupil foundation amount from \$6,964 to \$7,011 (0.7%) and an estimated 7,311 additional full-time equivalent students. The compensatory aid program is expected to increase by \$53.1 million (4.1%). This program provides additional funding to local school systems based on their enrollment of students eligible for free and reduced-price meals. The projected increase is due to a 3.4% increase in the number of children who are eligible for free and reduced-price meals and from the increase in the per-pupil foundation amount.

Exhibit 3
Annual Change in State Aid to Local Governments
Fiscal 2011-2018



The estimated \$64.7 million increase in State aid to county and municipal governments represents another major factor in the overall increase in State aid for fiscal 2018. Nearly half of this portion of growth is due to the projected increase of \$30.2 million in gaming impact grants, largely driven by the anticipated December 2016 opening date for the gaming facility in Prince George’s County. This not only adds another source of video lottery terminal revenues, from which a portion is distributed to local jurisdictions where a video lottery facility is located, but also initiates the distribution of 5.0% of table game revenues to these local jurisdictions.

While overall direct State aid increases, State retirement costs for public school teachers decrease by \$30.9 million or 4.0% in fiscal 2018 due to a reduction in the State contribution and reinvestment rates. The combined rates decline from 17.31% in fiscal 2017 to 16.45% in fiscal 2018. Similarly, State retirement costs for librarians and community college faculty decrease by \$2.5 million in fiscal 2018.

The State also provides grants for specific capital projects, including funding for school construction, county detention centers, low-income housing, and water supply facilities. Proceeds from the sale of State bonds are the primary source of funding for these capital project grants. The State capital and operating budgets include approximately \$527.4 million in fiscal 2017 and an estimated \$540.3 million in fiscal 2018 for State programs providing grants primarily to local governments. As **Exhibit 4** shows, public school construction projects account for well over half of total capital funds earmarked for local projects in fiscal 2017 and 2018, while environment and recreation programs account for about one-quarter of grants in fiscal 2017 and about one-fifth in fiscal 2018.

Exhibit 4
State Funding for Local Government Capital Projects
(\$ in Millions)

	FY 17	FY 18	FY 17	FY 18
	<u>Amount</u>	<u>Forecasted</u>	<u>% of Total</u>	<u>% of Total</u>
Education				
Public School Construction	\$320.0	\$320.0	60.7%	59.2%
Community College Projects	59.4	60.0	11.3%	11.1%
Public Libraries	5.0	5.0	0.9%	0.9%
Subtotal	\$384.4	\$385.0	72.9%	71.3%
Environment and Recreation				
Chesapeake Bay Restoration Fund	\$94.0	\$54.0	17.8%	10.0%
Chesapeake Bay Water Quality Funds	25.0	41.0	4.7%	7.6%
Water Supply Financial Assistance Program	2.5	2.5	0.5%	0.5%
Waterway Improvement Fund	5.6	4.9	1.1%	0.9%
Community Parks and Playgrounds	2.5	2.5	0.5%	0.5%
Hazardous Substance Cleanup	0.2	1.0	0.0%	0.2%
Mining Remediation Program	0.5	0.5	0.1%	0.1%
Subtotal	\$130.2	\$106.4	24.7%	19.7%
Health/Social				
Strategic Demolition and Smart Growth Impact Project	\$0.0	\$26.6	0.0%	4.9%
Community Health Facilities Grant Program	4.8	5.7	0.9%	1.1%
Community Legacy Program	0.0	6.0	0.0%	1.1%
Partnership Rental Housing Program	6.5	6.0	1.2%	1.1%
Shelter & Transitional Housing Facilities	1.5	4.5	0.3%	0.8%
Subtotal	\$12.8	\$48.9	2.4%	9.0%
Total	\$527.4	\$540.3	100.0%	100.0%

Note: Fiscal 2018 figures reflect funding levels programmed in the 2016 *Capital Improvement Program* and Department of Legislative Services' fiscal 2018 baseline budget estimates.

Local Government

Allocation of State Aid among Local Jurisdictions

The majority of State aid to local governments is distributed inversely to local property and income wealth so that jurisdictions with greater capacity to raise revenue from local sources receive less State aid.

Reliance on State Aid

State aid is the largest revenue source for half of county governments in Maryland, representing 27.9% of total county revenues. In Anne Arundel, Baltimore, Calvert, Carroll, Garrett, Harford, Kent, Queen Anne's, and Worcester counties, State aid is the second largest revenue source after property taxes, while in Howard, Montgomery, and Talbot counties, State aid is the third largest revenue source after both property and income taxes.

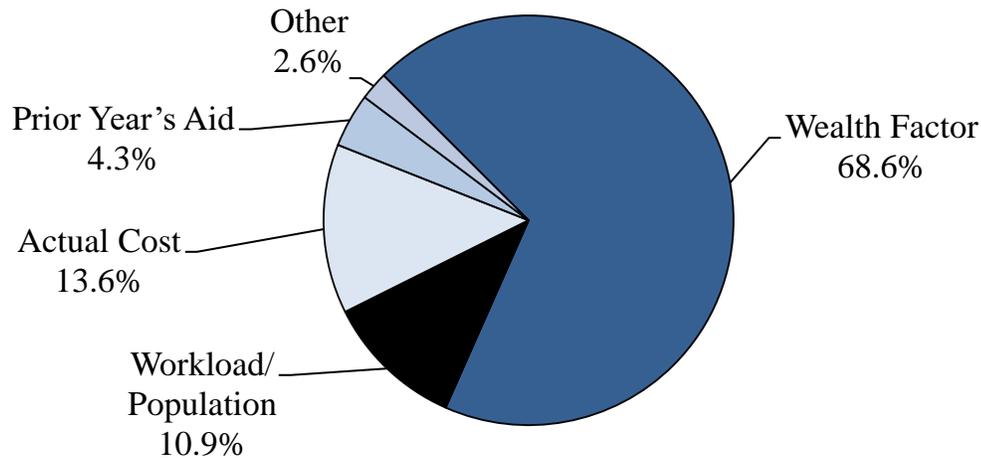
Dependence on State aid varies, with less affluent jurisdictions relying on State aid as their primary revenue source, while more affluent jurisdictions rely more heavily on local property and income taxes. For example, State aid accounts for 18.0% of total revenues in Montgomery County but reaches 51.9% in Caroline County. This difference is due to the fact that State aid is distributed inversely to local wealth. Utilizing local wealth measures to distribute State aid attempts to offset the inequalities in the revenue raising capacity among local jurisdictions.

State aid is the fourth largest revenue source for municipalities, representing 5.3% of total revenues. The reliance on State aid varies across the State, ranging from 2.0% of total revenues for municipalities in Talbot County to 30.9% for municipalities in Somerset County, where State aid is the second largest revenue source. Most State aid to municipalities is targeted to transportation, police protection, parks and recreation services, and community development projects.

Distribution Basis for State Aid

The State utilizes nearly 80 programs to allocate funding to local governments. Programs that distribute funding inversely to local wealth accounted for about 70% of State aid in fiscal 2017. Most of these programs also base State aid on a workload measure, such as school enrollment or population. In fiscal 2000, around 56% of State aid was distributed based on local wealth. The increased utilization of local wealth as a basis to distribute State aid improves fiscal equity among jurisdictions by making certain jurisdictions less dependent on their own tax base to fund public services. **Exhibit 1** shows State aid by the basis for distribution.

Exhibit 1
State Aid by Basis for Distribution
Fiscal 2017



Trends
(\$ in Millions)

	<u>FY 2000</u>	<u>% of Total</u>	<u>FY 2017</u>	<u>% of Total</u>
Wealth Factor	\$1,935.5	56.1%	\$5,045.1	68.6%
Workload/Population	697.0	20.2%	800.7	10.9%
Actual Cost	513.4	14.9%	1,003.9	13.6%
Prior Year's Aid	146.1	4.2%	314.0	4.3%
Other	158.3	4.6%	191.4	2.6%
Total	\$3,450.3	100.0%	\$7,355.2	100.0%

Source: Department of Legislative Services

Wealth Equalizing and Targeting of Education Aid

Because funding public education is a shared State and local responsibility, part of the State's constitutional responsibility to provide a "thorough and efficient system of free public schools" involves offsetting the disparities in taxable wealth among the counties. The State education aid structure compensates for wealth differences by providing less education aid per pupil to the more wealthy jurisdictions and more education aid per pupil to the less wealthy jurisdictions through a number of "wealth-equalized" funding formulas. Although most State aid formulas are designed to have the State pay roughly one-half of program costs, the State's education aid share for the less wealthy jurisdictions is higher than 50%, and the State's education

aid share for more wealthy jurisdictions is lower than 50%. **Exhibit 2** illustrates the inverse relationship between local wealth and direct State education aid per pupil.

Enhanced targeting of State education aid was a primary goal of the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002). The targeted funds are based on enrollment-driven formulas for three groups: (1) special education students; (2) students eligible for free and reduced-price meals; and (3) students with limited English proficiency. The Targeted Student Index shown in Exhibit 2 compares for each county the sum of students in each of these categories to full-time equivalent enrollment. Because a student may be in more than one of these groups, an index result of over 100% is possible, as in the case of Baltimore City.

Results of the State Education Aid Structure

Exhibit 2 shows how State education aid per pupil is driven by each county's wealth and by the share of its student population that is identified as being at greater risk of performing below State standards. For example, the exhibit shows that Baltimore City has the fifth lowest wealth per pupil in fiscal 2017 and the student population with the greatest needs. As a result, Baltimore City received the most direct State education aid per student at \$11,285. Somerset County, with the third lowest wealth per pupil in the State and a student population with relatively high needs (second highest), received the second highest per pupil direct State education aid amount at \$10,945. Talbot and Worcester counties, which have the highest wealth per pupil figures in fiscal 2017, received the two lowest levels of direct State education aid per pupil, at \$3,221 and \$3,146, respectively.

Exhibit 2
Local Needs and Wealth and Direct State Aid Per Pupil
Fiscal 2017

Targeted Student Index		Local Wealth Per Pupil		Direct Education Index Per Pupil				
1	Baltimore City	108.5%	24	Wicomico	\$278,266	1	Baltimore City	\$11,285
2	Somerset	91.9%	23	Caroline	286,009	2	Somerset	10,945
3	Prince George's	91.0%	22	Somerset	297,340	3	Wicomico	9,888
4	Dorchester	80.6%	21	Allegany	304,595	4	Caroline	9,784
5	Wicomico	76.0%	20	Baltimore City	321,288	5	Allegany	9,609
6	Caroline	73.0%	19	Washington	351,976	6	Dorchester	9,057
7	Allegany	72.4%	18	Dorchester	360,325	7	Prince George's	8,881
8	Kent	67.2%	17	Prince George's	388,709	8	Washington	7,763
9	Baltimore	63.6%	16	Cecil	389,322	9	Cecil	7,068
10	Cecil	60.8%	15	Charles	404,164	10	Charles	6,597
11	Washington	60.6%	14	Frederick	440,342	11	Garrett	6,005
12	Montgomery	60.2%	13	St. Mary's	443,232	12	St. Mary's	5,967
13	Talbot	60.1%	12	Harford	469,741	13	Baltimore	5,940
14	Worcester	58.8%	11	Calvert	479,660	14	Frederick	5,929
15	Garrett	57.3%	10	Carroll	479,791	15	Harford	5,646
16	Anne Arundel	48.3%	9	Baltimore	507,517	16	Carroll	5,375
17	Charles	47.9%	8	Howard	578,584	17	Calvert	5,333
18	Harford	45.4%	7	Queen Anne's	587,536	18	Kent	5,148
19	St. Mary's	43.5%	6	Garrett	622,833	19	Queen Anne's	4,623
20	Frederick	42.0%	5	Anne Arundel	625,504	20	Anne Arundel	4,517
21	Queen Anne's	39.9%	4	Montgomery	735,768	21	Howard	4,495
22	Howard	35.3%	3	Kent	852,043	22	Montgomery	4,372
23	Calvert	33.0%	2	Talbot	1,027,063	23	Talbot	3,221
24	Carroll	32.2%	1	Worcester	1,126,837	24	Worcester	3,146
	Statewide	63.9%		Statewide	\$513,532		Statewide	\$6,553

Targeted Student Index equals the sum of students with disabilities, students eligible for free and reduced-price meals, and students with limited English proficiency divided by the number of full-time equivalent (FTE) students. Because of overlap among these three at-risk populations, the figure may be greater than 100%. Per pupil measures are based on FTE.

Source: Department of Legislative Services

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Local Government

Local Revenue Trends

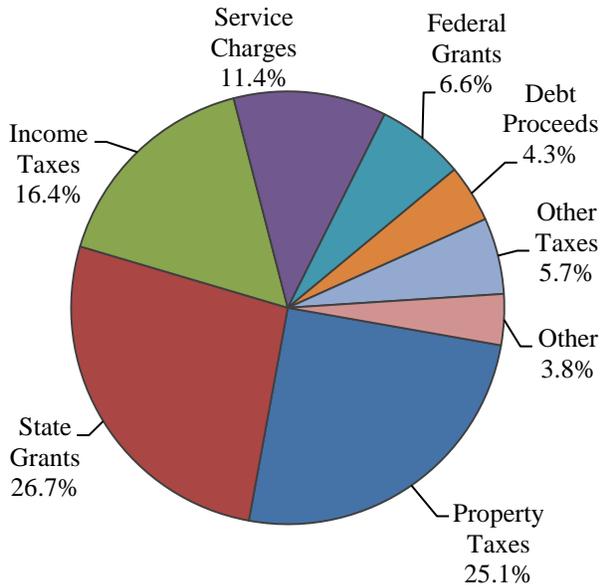
Local taxes account for approximately 47% of county revenues and represent the primary local revenue source for most counties. Overall, county governments are projecting a modest increase in local tax revenues in fiscal 2017. However, several local governments continue to experience limited growth or declines in local income tax collections.

General fund revenues for county governments are projected to total \$15.0 billion in fiscal 2017. As shown in **Exhibit 1**, this represents a 3.2% average annual increase over the amount of general fund revenues collected in fiscal 2015. The projected growth in general fund revenues is slightly below the estimated growth in local tax revenues, which includes both general and special fund revenues. The average annual increase in local tax revenues is projected at 3.8% in fiscal 2017. In total, local governments are projected to collect \$14.7 billion in local tax revenues, a \$1.1 billion increase since fiscal 2015. **Exhibit 2** shows the growth in local tax revenues in fiscal 2015 through 2017.

The local government revenue outlook is influenced by two primary factors: a rebound in local income tax collections due to improvements in the overall State economy; and moderate growth in property tax collections. Local governments are projected to collect \$5.2 billion in local income tax revenues in fiscal 2017, a \$397.8 million increase since fiscal 2015. This represents an average annual increase of 4.1% over the two-year period. Property tax collections are expected to increase by \$531.2 million over the two-year period, representing an average annual increase of 3.5%. Local property tax collections will total \$7.9 billion in fiscal 2017. Local property tax collections have begun to grow in recent years after several years of steady decline due to the downturn in the State's housing market. As shown in **Exhibit 3**, property assessments declined sharply in recent years and only began to increase beginning in fiscal 2014.

Two other local revenue sources significantly affected by the downturn in the housing market include recordation and transfer taxes. At the height of the real estate market, local governments collected over \$1.2 billion in recordation and transfer taxes, as shown in **Exhibit 4**. By fiscal 2011, collections totaled only \$511.8 million. In fiscal 2017, local governments are projecting \$877.2 million in recordation and transfer tax collections. This represents a \$365.4 million increase over the amount collected in fiscal 2011 and illustrates that recordation and transfer tax collections continue to rebound. A more detailed depiction of the growth in local tax revenues in fiscal 2017 is provided in **Exhibit 5**.

**Exhibit 1
Sources of Revenue for Counties and Baltimore City**



FY 2014 = \$28.7 billion

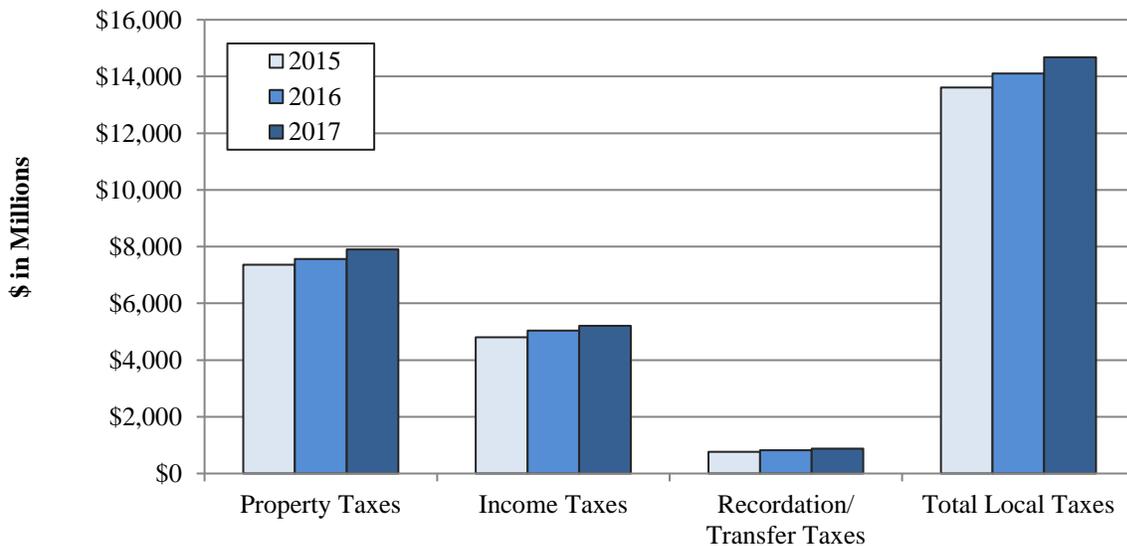
**Average Annual Change
Fiscal 2015-2017**

Property Taxes	3.5%
Income Taxes	4.1%
Recordation Taxes	8.6%
Transfer Taxes	5.6%
Hotel/Motel Taxes	3.4%
Admissions Taxes	3.8%

Total Local Taxes	3.8%
General Fund Revenues	3.2%

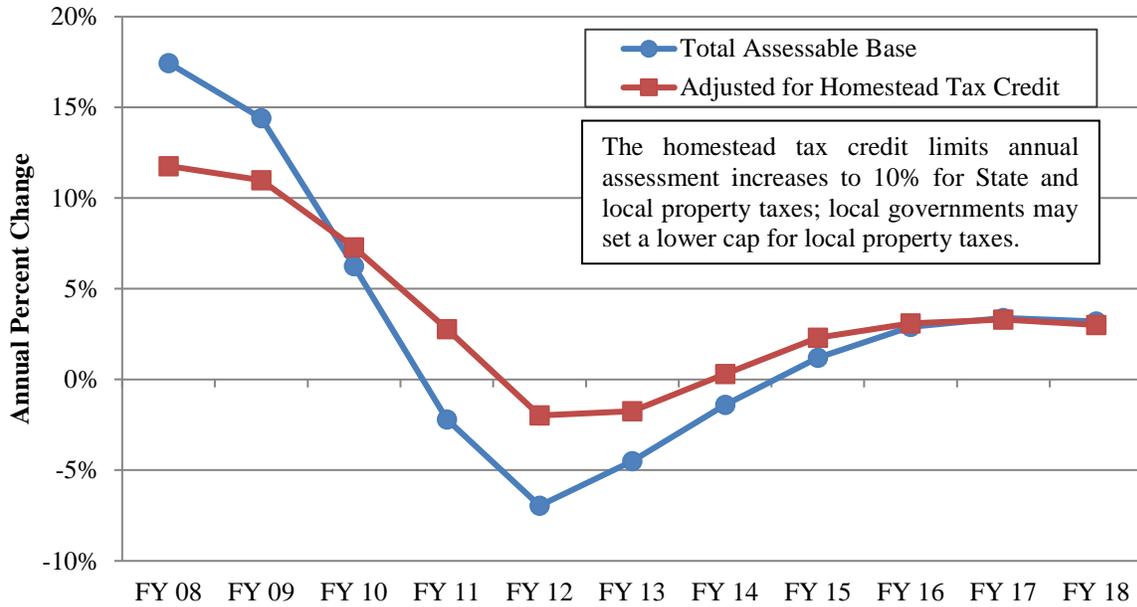
Source: Department of Legislative Services; county budgets

**Exhibit 2
Local Tax Revenue Inches Upward
Fiscal 2015-2017**



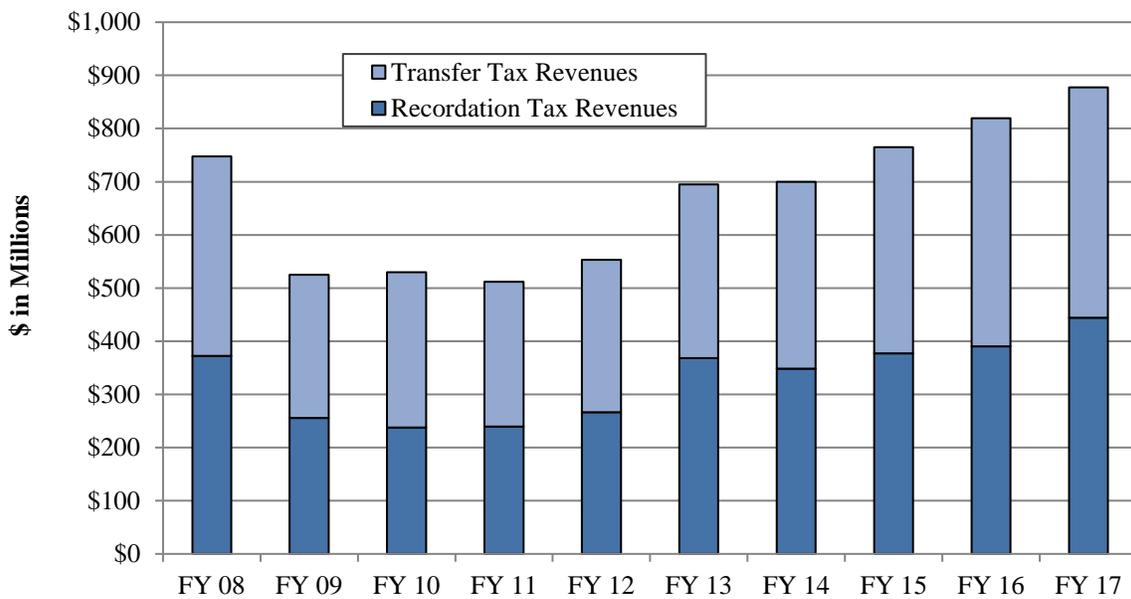
Source: Department of Legislative Services; county budgets

Exhibit 3
Homestead Tax Credit Softened Impact on County Assessable Base



Source: Department of Legislative Services; county budgets

Exhibit 4
Real Estate Meltdown Impacts Recordation and Transfer Taxes



Source: Department of Legislative Services; county budgets

Exhibit 5
Total Local Taxes for Fiscal 2015-2017

County	FY 2015	FY 2016	FY 2017	FY 2015-2016 \$ Difference	FY 2016-2017 \$ Difference	Average Annual Difference
Allegany	\$70,821,090	\$69,193,541	\$71,796,593	-\$1,627,549	\$2,603,052	0.7%
Anne Arundel	1,237,013,688	1,273,172,400	1,297,886,300	36,158,712	24,713,900	2.4%
Baltimore City	1,298,676,667	1,319,548,064	1,367,001,159	20,871,397	47,453,095	2.6%
Baltimore	1,703,481,435	1,758,930,686	1,811,186,914	55,449,251	52,256,228	3.1%
Calvert	218,074,582	221,957,103	235,283,103	3,882,521	13,326,000	3.9%
Caroline	39,653,677	38,437,347	39,856,604	-1,216,330	1,419,257	0.3%
Carroll	347,564,748	357,457,910	369,328,862	9,893,162	11,870,952	3.1%
Cecil	162,566,956	169,639,435	171,187,135	7,072,479	1,547,700	2.6%
Charles	340,187,238	360,353,300	362,177,500	20,166,062	1,824,200	3.2%
Dorchester	44,270,785	43,695,018	44,930,301	-575,767	1,235,283	0.7%
Frederick	495,421,468	497,342,360	527,163,569	1,920,892	29,821,209	3.2%
Garrett	64,574,573	63,021,883	66,131,272	-1,552,690	3,109,389	1.2%
Harford	509,280,783	517,078,531	534,966,000	7,797,748	17,887,469	2.5%
Howard	1,082,658,589	1,109,244,216	1,142,009,988	26,585,627	32,765,772	2.7%
Kent	44,890,915	45,399,749	44,632,566	508,834	-767,183	-0.3%
Montgomery	3,331,305,527	3,508,392,043	3,758,234,712	177,086,516	249,842,669	6.2%
Prince George's	1,741,820,295	1,858,566,000	1,910,395,200	116,745,705	51,829,200	4.7%
Queen Anne's	115,077,757	117,229,232	119,865,725	2,151,475	2,636,493	2.1%
St. Mary's	200,000,814	205,106,992	210,119,902	5,106,178	5,012,910	2.5%
Somerset	21,819,165	22,030,255	23,302,379	211,090	1,272,124	3.3%
Talbot	73,996,631	72,621,500	71,894,000	-1,375,131	-727,500	-1.4%
Washington	203,457,112	204,025,180	208,969,940	568,068	4,944,760	1.3%
Wicomico	113,500,231	108,601,285	113,644,084	-4,898,946	5,042,799	0.1%
Worcester	157,072,375	165,167,382	171,603,788	8,095,007	6,436,406	4.5%
Total	\$13,617,187,101	\$14,106,211,412	\$14,673,567,596	\$489,024,311	\$567,356,184	3.8%

Source: Department of Legislative Services; county budgets

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Local Government

Local Government Tax Actions

Four county governments had to raise the local property tax rate in order to balance their budgets and improve funding to public schools, with two counties increasing the rate above the charter limit. However, two county governments were able to reduce local property tax rates slightly.

Local Government Tax Rates

More local jurisdictions chose to increase local tax rates in fiscal 2017 than chose to decrease them. As shown in **Exhibit 1**, six counties changed their local property tax rates, with four counties increasing their rates and two counties decreasing them. The rate increases in Montgomery and Talbot counties exceeded those counties' charter limits. In addition, Calvert County increased its income tax rate. Montgomery County increased its recordation tax rate, and Frederick County increased its hotel rental tax rate. No county altered its transfer or admissions and amusement tax rate. A comparison of local tax rates for fiscal 2016 and 2017 is provided in **Exhibit 2**.

Exhibit 1
Counties Changing Local Tax Rates
Fiscal 2015-2017

	<u>Fiscal 2015</u>		<u>Fiscal 2016</u>		<u>Fiscal 2017</u>	
	▲	▼	▲	▼	▲	▼
Real Property	3	4	5	4	4	2
Local Income	0	1	1	1	1	0
Recordation	0	0	0	0	1	0
Transfer	0	0	2	0	0	0
Admissions/Amusement	0	0	1	0	0	0
Hotel Rental	1	0	1	0	1	0

Note: ▲ represents a tax rate increase. ▼ represents a tax rate decrease.

Source: 2016 Local Government Budget and Tax Rate Survey, Department of Legislative Services/Maryland Association of Counties

Exhibit 2
Local Tax Rates – Fiscal 2016 and 2017

County	Real Property		Local Income		Recordation		Transfer		Admissions/Amusement		Hotel Rental	
	FY 2016	FY 2017	CY 2016	CY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017
Allegany	\$0.978	\$0.977	3.05%	3.05%	\$3.50	\$3.50	0.5%	0.5%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.923	0.915	2.50%	2.50%	3.50	3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.248	2.248	3.20%	3.20%	5.00	5.00	1.5%	1.5%	10.0%	10.0%	9.5%	9.5%
Baltimore	1.100	1.100	2.83%	2.83%	2.50	2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	0.892	0.952	2.80%	3.00%	5.00	5.00	0.0%	0.0%	1.0%	1.0%	5.0%	5.0%
Caroline	0.980	0.980	2.73%	2.73%	5.00	5.00	0.5%	0.5%	0.0%	0.0%	5.0%	5.0%
Carroll	1.018	1.018	3.03%	3.03%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Cecil	0.991	0.991	2.80%	2.80%	4.10	4.10	0.5%	0.5%	6.0%	6.0%	3.0%	3.0%
Charles	1.205	1.205	3.03%	3.03%	5.00	5.00	0.5%	0.5%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.976	0.976	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.060	1.060	2.96%	2.96%	6.00	6.00	0.0%	0.0%	0.0%	0.0%	3.0%	5.0%
Garrett	0.990	0.990	2.65%	2.65%	3.50	3.50	1.0%	1.0%	6.0%	6.0%	6.0%	6.0%

County	Real Property		Local Income		Recordation		Transfer		Admissions/Amusement		Hotel Rental	
	FY 2016	FY 2017	CY 2016	CY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017
Harford	\$1.042	\$1.042	3.06%	3.06%	\$3.30	\$3.30	1.0%	1.0%	5.0%	5.0%	6.0%	6.0%
Howard	1.190	1.190	3.20%	3.20%	2.50	2.50	1.0%	1.0%	7.5%	7.5%	7.0%	7.0%
Kent	1.022	1.022	2.85%	2.85%	3.30	3.30	0.5%	0.5%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.999	1.038	3.20%	3.20%	3.45	4.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.374	1.374	3.20%	3.20%	2.75	2.75	1.4%	1.4%	10.0%	10.0%	7.0%	7.0%
Queen Anne's	0.847	0.847	3.20%	3.20%	4.95	4.95	0.5%	0.5%	5.0%	5.0%	5.0%	5.0%
St. Mary's	0.852	0.852	3.00%	3.00%	4.00	4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	1.000	1.000	3.15%	3.15%	3.30	3.30	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%
Talbot	0.536	0.547	2.40%	2.40%	6.00	6.00	1.0%	1.0%	5.0%	5.0%	4.0%	4.0%
Washington	0.948	0.948	2.80%	2.80%	3.80	3.80	0.5%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.952	0.952	3.20%	3.20%	3.50	3.50	0.0%	0.0%	6.0%	6.0%	6.0%	6.0%
Worcester	0.835	0.835	1.75%	1.75%	3.30	3.30	0.5%	0.5%	3.0%	3.0%	4.5%	4.5%

Notes: The real property tax rates shown for Charles, Howard, Montgomery, and Prince George's counties include special tax rates. Real property tax is per \$100 of assessed value. Income is a percentage of taxable income. Recordation tax is per \$500 of transaction.

Source: 2016 Local Government Budget and Tax Rate Survey, Department of Legislative Services/Maryland Association of Counties

Property Tax

For fiscal 2017, four counties (Calvert, Cecil, Montgomery, and Talbot) increased their real property tax rates. Allegany and Anne Arundel counties decreased their real property tax rates. Real property tax rates range from \$0.547 per \$100 of assessed value in Talbot County to \$2.248 in Baltimore City.

Local Income Tax

Calvert County was the only jurisdiction to change its local income tax rate for calendar 2017, increasing the rate from 2.8% to 3.0%. Local income tax rates range from 1.75% in Worcester County to 3.2% in Baltimore City and Howard, Montgomery, Prince George's, Queen Anne's, and Wicomico counties.

Recordation Tax

Montgomery County was the only jurisdiction to change its recordation tax rate for fiscal 2017, increasing the rate from \$3.45 to \$4.45 per \$500 of transaction. Recordation tax rates range from \$2.50 per \$500 of transaction in Baltimore and Howard counties to \$6.00 per \$500 of transaction in Frederick and Talbot counties.

Transfer Tax

No county altered its transfer tax rate for fiscal 2017. Local transfer tax rates range from 0.5% in eight counties (Allegany, Caroline, Cecil, Charles, Kent, Queen Anne's, Washington, and Worcester) to 1.5% in Baltimore City and Baltimore County. Five counties (Calvert, Carroll, Frederick, Somerset, and Wicomico) do not impose a tax on property transfers.

Admissions and Amusement Tax

No county altered its admissions and amusement tax rate for fiscal 2017. Caroline and Frederick counties are the only jurisdictions that do not impose an admissions and amusement tax. Currently, admissions and amusement tax rates range from 0.5% in Dorchester County to 10.0% in six jurisdictions (Baltimore City and Anne Arundel, Baltimore, Carroll, Charles, and Prince George's counties).

Hotel Rental Tax

One county, Frederick, increased its hotel rental tax rate in fiscal 2017, from 3% to 5%. No other county altered its hotel rental tax rate. Hotel rental tax rates range from 3.0% in Cecil County to 9.5% in Baltimore City.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5% or the increase in the Consumer Price Index. In Montgomery County, the growth in property tax revenues is limited to the increase in the Consumer Price Index; however, this limitation does not apply to new construction. In addition, the limitation may be overridden by a unanimous vote of all nine county council members. In Prince George's County, the general property tax rate is capped at \$0.96 per \$100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2% or the increase in the Consumer Price Index.

The counties may exceed the charter limitations on local property taxes for the purpose of funding the approved budget of the local board of education. If a local property tax rate is set above the charter limit, the county governing body may not reduce funding provided to the local board of education from any other local source and must appropriate to the local board of education all of the revenues generated from any increase beyond the existing charter limit. Any use of this authority must be reported annually to the Governor and the General Assembly. This authority was adopted at the 2012 session to ensure that counties have the fiscal ability to meet new maintenance of effort requirements. In fiscal 2013, Talbot County became the first jurisdiction to exercise this new authority by establishing a \$0.026 supplemental property tax rate for the local board of education. No jurisdiction exercised this authority in fiscal 2014 or 2015. In fiscal 2016, Prince George's County became the second county to exercise this authority by enacting a \$0.04 supplemental property tax rate to fund its schools. In fiscal 2017, Talbot County again exceeded its charter limit by establishing a \$0.0086 supplemental property tax rate for public education. Montgomery County exceeded the charter limit through a unanimous vote by the county council.

Local Government

Local Government Salary Actions

The majority of county governments and boards of education provided salary enhancements to their employees in fiscal 2017, with 13 counties and 15 boards of education providing cost-of-living adjustments and 16 counties and 19 boards providing merit/step increases.

Local Salary Actions

With salary actions still pending in 2 counties, at least 21 counties are providing their employees a cost-of-living adjustment (COLA), general salary increase (GSI), step increase, or combination of enhancements in fiscal 2017, compared to 20 counties in fiscal 2016. More specifically, 13 counties have indicated that they provided their employees with a COLA or GSI in fiscal 2017, compared to 14 in fiscal 2016. Sixteen counties are providing step or merit increases in fiscal 2017, compared to 13 in fiscal 2016.

Similarly, the number of boards of education providing salary enhancements remained relatively constant in fiscal 2017. With 2 pending salary actions, at least 21 boards of education are providing a COLA, GSI, step increase, or combination of enhancements for their employees in fiscal 2017, compared to 23 boards that did so in fiscal 2016. Fifteen boards of education have indicated that they are providing COLAs or general salary increases for their employees in fiscal 2017, while 14 boards did so in fiscal 2016. Additionally, 19 boards of education provided step or merit increases for their employees in fiscal 2017, compared to 21 boards in fiscal 2016. **Exhibit 1** compares local salary actions in fiscal 2016 and 2017, while **Exhibits 2** and **3** show specific local salary actions for fiscal 2017.

No county governments or boards of education designated service reduction days or implemented employee furloughs in fiscal 2016 or 2017. While no county government indicated plans to lay off employees in fiscal 2017, 13 employees from one county government were laid off in fiscal 2016. One school board plans to eliminate 172 positions in fiscal 2017 through employee layoffs, compared to 245 positions at three local school systems in fiscal 2016. Two boards of education also eliminated positions through attrition in fiscal 2016. **Exhibit 4** describes the local government furlough, salary reduction, and layoff plans for fiscal 2017 and changes made during fiscal 2016.

State Salary Actions

For comparison purposes, the State awarded no salary enhancements of any kind to its employees in fiscal 2016, and only merit increases were awarded in fiscal 2017 with no general salary increase.

Exhibit 1
Local Government Salary Actions
Fiscal 2016 and 2017

<u>Salary Action</u>	<u>County Government</u>		<u>Public Schools</u>	
	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2017</u>
COLA/GSI				
No COLA/GSI	10	9	10	5
COLA/GSI	14	13 ¹	14	15
Still Pending	0	2	0	2
Stipend/Bonus²	1	0	1	2
Step/Merit Increases³	13	16	21	19
Furlough/Salary Reductions	0	0	0	0
Layoffs	1	0	3	1
	<u>State Government</u>		<u>CPI-Urban Consumers⁴</u>	
	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2017</u>
COLA Amount	0.0%	0.0%	0.7%	1.8%
One-time Bonus	\$0	\$0		
Furloughs	No	No		
Step/Merit Increases	No	Yes		

COLA: cost-of-living adjustment

CPI: Consumer Price Index

GSI: general salary increase

¹ Although included in the count as a GSI in fiscal 2017, Frederick County limited its GSI to law enforcement and corrections officers. While remaining county employees received no GSI, they did receive a step increase.

² For fiscal 2016, Charles County employees received a bonus; and Carroll County Public Schools employees received a bonus in addition to a COLA. For fiscal 2017, Garrett County Public Schools employees receive a \$500 bonus; and teachers and support staff in St. Mary's County, in addition to a COLA increase, receive a \$750 bonus.

³ Although included in the count as a general step increase in fiscal 2016 and 2017, Wicomico County limited its step increase in both fiscal years to its police officers.

⁴ Forecast of the CPI for 2016 (actual) and 2017 (estimate) is an average forecast taken from Moody's Analytics and IHS, Inc.

Source: 2016 Local Government Salary Action Survey, Department of Legislative Services

Exhibit 2
County Government Salary Actions in Fiscal 2017

County	COLA/GSI	Step/Merit	Additional Comments
Allegany	2.0%	No	Salary increases for correctional officers, patrol deputies, and paramedics not settled. Sheriff deputies elected to forego salary increases in order to be enrolled in the State pension system (LEOPS).
Anne Arundel	0.0%	Yes	
Baltimore City	Pending	Pending	Some employee groups awarded 2% COLA, but salary increases for the majority of city employees not settled.
Baltimore	2.0%	Yes	
Calvert	0.0%	Yes	
Caroline	2.0%	No	
Carroll	1.5%	Yes	Majority of county employees receive 1.5% COLA, while sheriff employees and detention center staff receive 4% and detention center officers receive 3%.
Cecil	1.0%	Yes	
Charles	0.0%	Yes	
Dorchester	0.0%	Yes	
Frederick	Limited	Yes	Law enforcement and corrections receive 11% and 9% GSI, respectively (market adjustment); remaining employees received no COLA/GSI.
Garrett	0.0%	No	
Harford	0.0%	Yes	
Howard	2.0%	Yes	COLA increase delayed until 1/1/2017.
Kent	3.0%	No	
Montgomery	1.0%	Yes	

County	COLA/GSI	Step/Merit	Additional Comments
Prince George's	Pending	Pending	Police, deputy sheriffs, and firefighters received a 1% COLA in FY 2017 and a delayed step increase in FY 2016 to be paid in FY 2017; remaining employee groups not settled.
Queen Anne's	1.0%	Yes	
St. Mary's	0.0%	Yes	
Somerset	3.5%	No	
Talbot	0.0%	Yes	
Washington	5.0%	No	
Wicomico	3.0%	Limited	Step increases for police/Fraternal Order of Police only.
Worcester	0.0%	Yes	
Total Jurisdictions Granting Increases	13	16	

Exhibit 3
Board of Education Salary Actions in Fiscal 2017

School System	COLA/GSI	Step/Merit	Additional Comments
Allegany	0.5%	Yes	
Anne Arundel	0.0%	Yes	Salary increases for administrators and support staff not settled.
Baltimore City	Pending	Pending	Paraprofessionals receive 1.5% COLA; salary increases for all other employee groups not settled.
Baltimore	2.0%	Yes	
Calvert	0.0%	Yes	
Caroline	0.0%	Yes	Administrators receive 3% COLA in lieu of step increase.
Carroll	2.0%	Yes	
Cecil	1.0%	Yes	
Charles	0.0%	Yes	While most school employees did not receive a COLA in FY 2017, teachers at Step 2 received a 1.5% COLA and teachers at Step 20 received a 1% COLA. This affected approximately 525 employees, which represents around 15% of employees.
Dorchester	1.5%	Yes	Teachers and administrators receive 1.5% GSI, and support staff receive 1%.
Frederick	2.0%	No	
Garrett	0.0%	No	All employees receive a \$500 one-time bonus.
Harford	1.5%	Yes	
Howard	2.0%	Yes	
Kent	1.0%	Yes	1% COLA for teachers only.
Montgomery	1.0%	Yes	
Prince George's	Pending	Pending	Salary increases for teachers and school administrators not settled; support staff receive 3% COLA, and custodial staff receive 2%.
Queen Anne's	0.0%	Yes	

School System	COLA/GSI	Step/Merit	Additional Comments
St. Mary's	Varies	No	New salary scale implemented for teachers and support staff, effectively increasing salaries by 1.5% and 3.1%, respectively. Both employee groups also receive a \$750 one-time bonus. Administrators receive step increase.
Somerset	1.0%	Yes	All employees receive a delayed step increase effective 1/15/17.
Talbot	1.0%	Yes	
Washington	0.5%	Yes	
Wicomico	1.0%	Yes	
Worcester	0.0%	Yes	
Total Jurisdictions Granting Increases	15	19	

Exhibit 4
Local Government Furloughs, Salary Reductions, and Layoffs:
Plans for Fiscal 2017 and Changes Made During Fiscal 2016

County	Furlough/Reduction	Layoffs	
Allegany	No	Yes	School system indicated that 1 position was involuntarily eliminated and an additional 28 positions were eliminated through attrition in fiscal 2016.
Baltimore City	No	Yes	City laid off 13 employees in fiscal 2016; school system laid off 217 employees (nonteaching positions) in fiscal 2016 and indicated plans to lay off 172 employees (nonteaching positions) in fiscal 2017.
Calvert	No	Yes	School system laid off 9 teachers and 18 support staff in fiscal 2016.
Carroll	No	Yes	School system eliminated 50 teacher positions through attrition in fiscal 2016.
Total Jurisdictions Implementing Plans	0	4	

Local Government

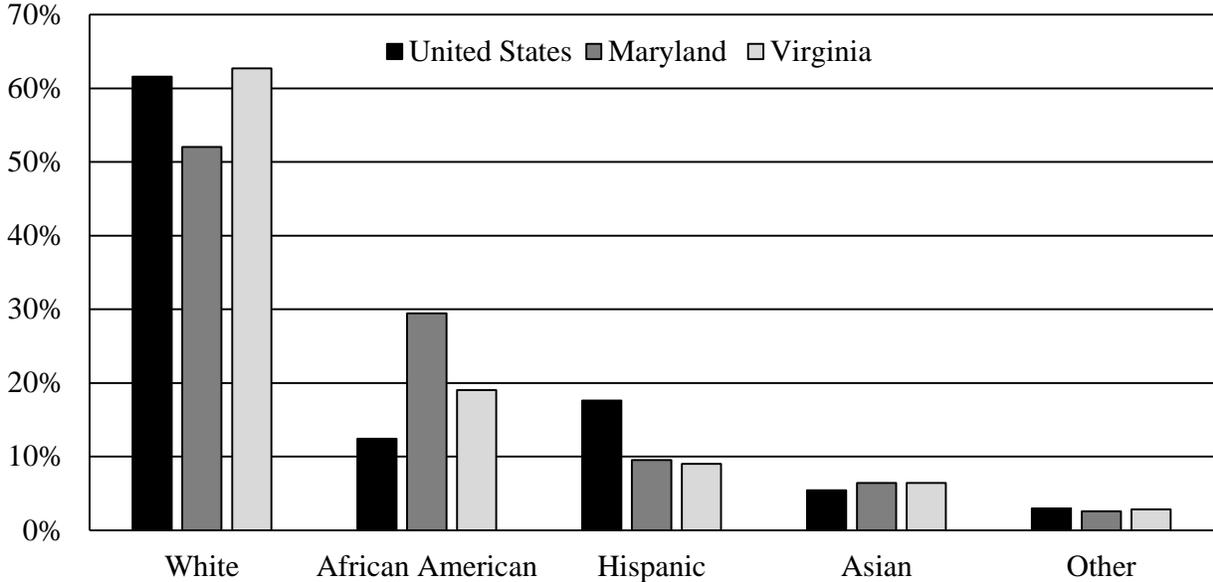
Maryland Demographic Profile

Maryland continues to be one of the most diverse and affluent states in the nation. Maryland ranks seventh in terms of the minority share of the State's population. The State has the highest median household income and the second lowest poverty rate.

Introduction

Maryland is one of the most diverse and affluent states in the nation. This affluence is spread across all different racial and economic categories of people. Various socio-economic characteristics including racial composition, poverty rates, and education attainment continue to influence policymakers at the federal, state, and local level. While the national population totals over 320 million people, Maryland accounts for 6 million of the total population. Even with a relatively small population, Maryland continues to be a leader in diversity as illustrated in **Exhibit 1**. Alongside its diverse array of people, Maryland continues to be ranked as one of the most affluent states with high median household income for people across all backgrounds and low poverty rates compared to the rest of the population in the United States.

Exhibit 1
Racial Composition in 2015

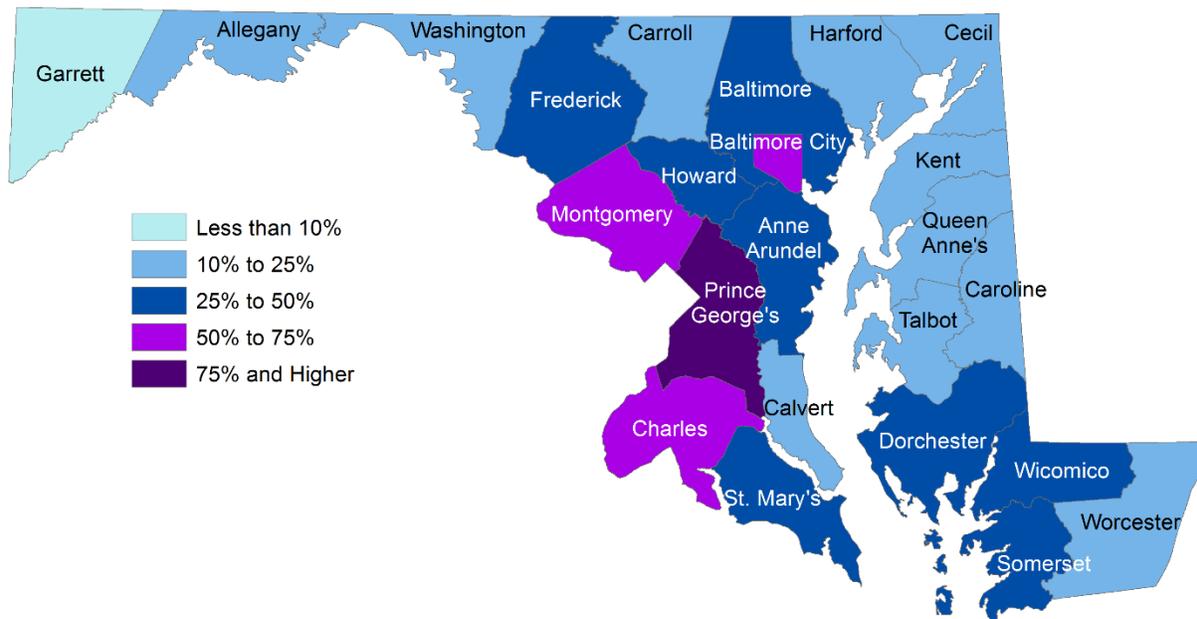


Source: U.S. Census Bureau; Maryland Department of Planning

Current Demographics

According to the U.S. Census Bureau, 6.0 million people currently live in Maryland. Minorities (including African Americans, Hispanics, and Asians) comprise 48.0% of the State's population. Maryland ranks seventh in terms of the minority share of the State population, while Hawaii ranks highest out of all other states. In Maryland, African Americans are the largest minority group followed by Hispanics and Asians. African Americans comprise 29.4% of the State's population; whereas Hispanics account for 9.5% followed by Asians at 6.4%. Four out of the 24 counties in the State have a majority minority population: Prince George's, Baltimore City, Charles, and Montgomery as illustrated in **Exhibit 2**.

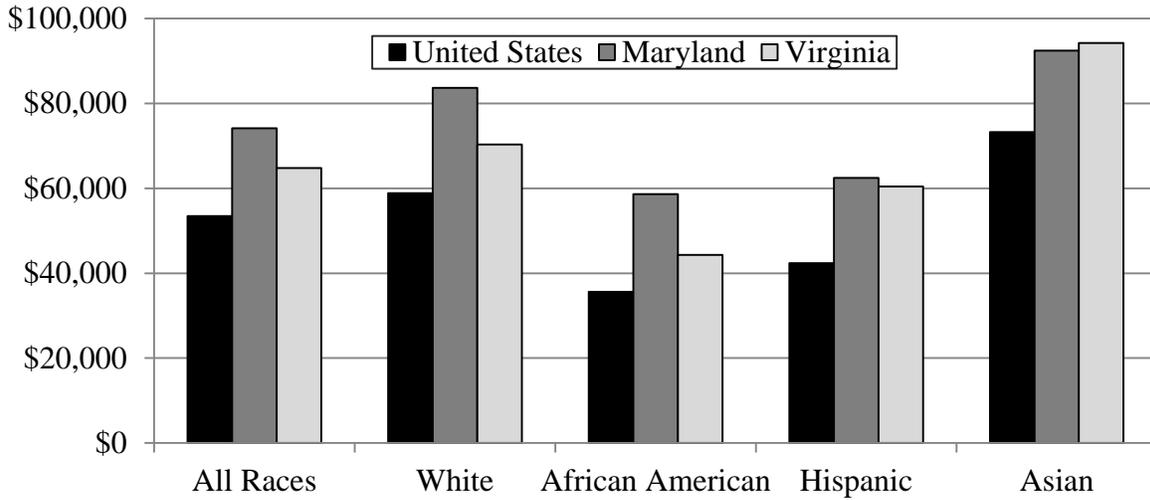
Exhibit 2
Minority Share of County Population



Source: U.S. Census Bureau; Maryland Department of Planning

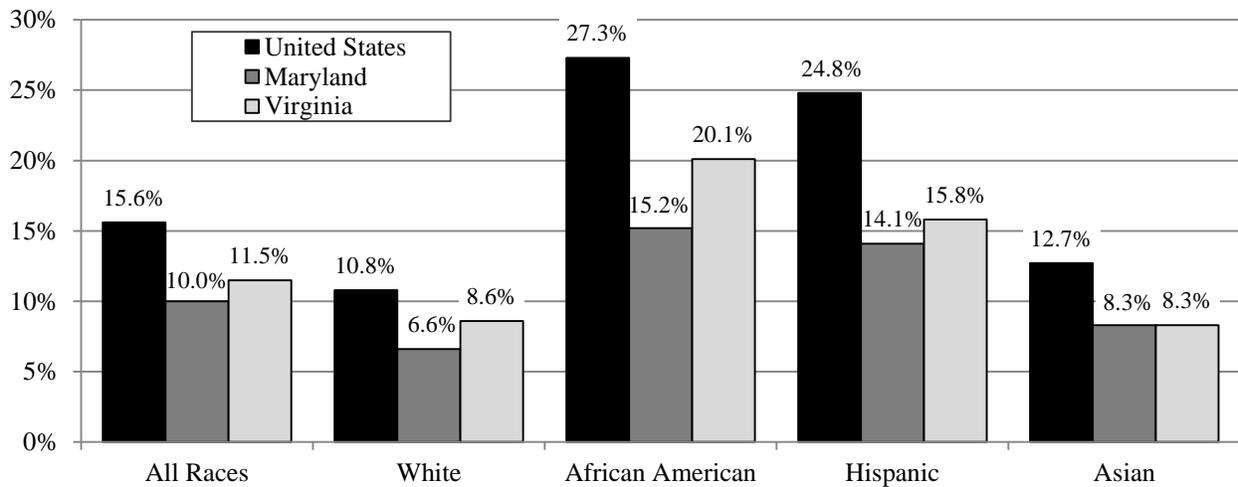
Maryland continues to be one of the most prosperous states in the nation with a high median household income and low poverty rate. Maryland had the highest median household income and the second lowest poverty rate in 2015. Maryland's median household income is \$75,847 compared to \$55,775 nationally. The poverty rate is 9.7% in Maryland compared to 14.7% nationally. The median household income and poverty rates are dissimilar when looked at through the lens of different racial, ethnic, and geographic areas in Maryland. Overall, Maryland still has better statistics for wealth and poverty for those groups than most other states in the nation as illustrated in **Exhibits 3 and 4**.

Exhibit 3
Median Household Income by Race/Ethnicity
2010-2014 Average



Source: U.S. Census Bureau

Exhibit 4
Poverty Rates by Race/Ethnicity
2010-2014 Average

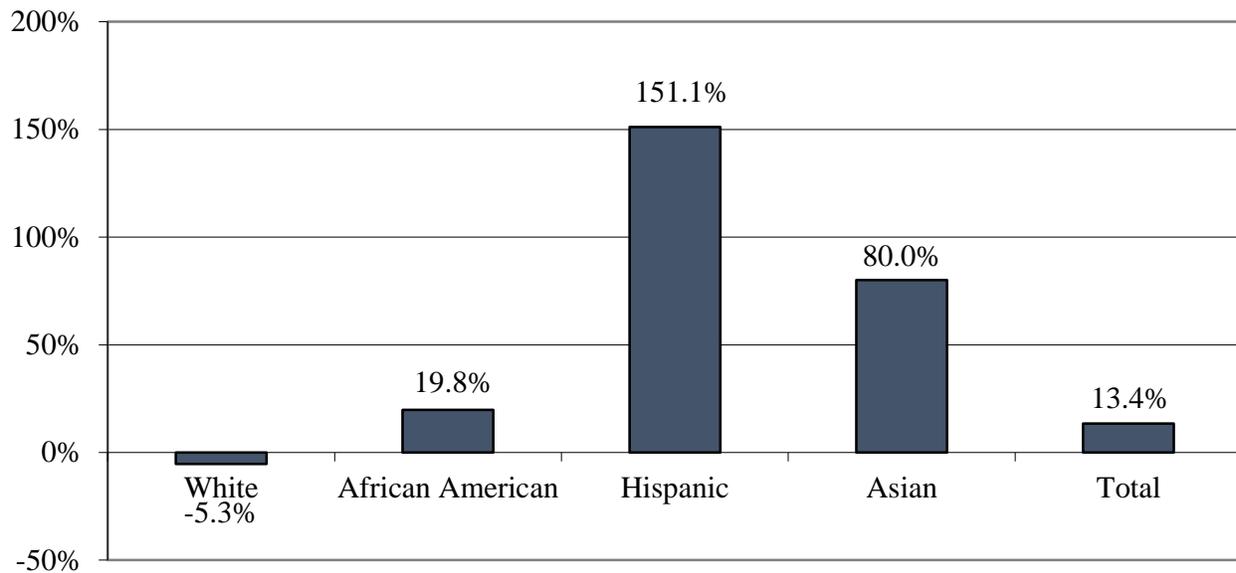


Source: U.S. Census Bureau

Population Trends

Over the last decade, Maryland has trended in growth for all racial and ethnic groups except for non-Hispanic Whites as illustrated in **Exhibit 5**. Due to this trend, Maryland moves closer to becoming a majority-minority State. Since 2000, the Hispanic population has more than doubled in Maryland. All counties have seen significant growth in their Hispanic population. Prince George's and Montgomery counties have led the way in gains for the Hispanic population. The Asian population has also seen gains in its population in every county in Maryland. Most of the growth has been situated in Montgomery, Howard, and Baltimore counties. The African American population has grown at a relatively slower rate since 2000. Baltimore City has seen a reduction in its African American residents, while Baltimore, Prince George's, and Montgomery counties have led the change in growth of their African American residents. Overall, since 2000, there has been a greater population change in minorities in the counties of Montgomery, Prince George's, and Baltimore than the rest of Maryland's counties combined.

Exhibit 5
Maryland Population Growth by Racial/Ethnic Composition
2000-2015



Source: Maryland Department of Planning

Local Government

Foreclosed and Vacant Residential Properties

The inventory of foreclosed and vacant residential properties in the State remains high. To help shrink the supply and address the problems associated with these properties, local jurisdictions utilize a variety of existing tools – and seek additional and innovative options – that might speed the return of these properties to productive use and thereby reduce fiscal strain on the localities and stem community blight.

Background

The number of foreclosure events on residential property in Maryland has remained stubbornly high, despite national trends downward. The Department of Labor, Licensing, and Regulation (DLLR) advises that, between the fourth quarter of 2014 and the third quarter of 2015, 20,447 properties were the subject of a notice of mortgage loan default or order to docket. Additionally, as of July 2016, the real estate website RealtyTrack lists Maryland among the top three states based on the percent of housing units with a foreclosure filing (approximately 0.9%).

DLLR maintains an Internet-based Foreclosed Property Registry (FPR) for information relating to foreclosure sales of residential property. Current law requires a foreclosure purchaser to submit an initial registration form to DLLR within 30 days of the sale and a final registration form within 30 days after a deed transferring title to the property has been recorded. DLLR advises that the FPR received 14,197 initial registrations during the 12-month period between October 1, 2015, and September 30, 2016, averaging 1,183 per month.

The number of vacant and abandoned residential properties in the State, as well as the proportion currently awaiting foreclosure, is unknown. State law does not require the registration of vacant or abandoned residential properties. However, in April 2016, *The Baltimore Sun* reported that there are nearly 17,000 vacant buildings in Baltimore City alone.

Problems Facing Local Governments

Vacant residential property, whether resulting from foreclosure or other circumstances, often becomes a nuisance to the community, which, in turn, lowers the value of surrounding properties and the community as a whole and encourages criminal activities on and near the property. In addition, when abandoned, vacant property does not generate tax revenue for the local government and may, in fact, become a costly drain on local government resources (e.g., enforcement of public safety laws and ongoing nuisance abatement such as weed cutting, removal of dumped garbage, rodent control, and boarding up of windows).

The Center for Community Progress in its August 2005 report, *Vacant Properties: The True Cost to Communities*, summarizes this predicament:

Local governments must address the increasing number of vacant properties, not only because of the negative impact they have on the surrounding community, but because of the numerous costs they impose. They strain the resources of local police, fire, building, and health departments, depreciate property values, reduce property tax revenue, attract crime, and degrade the quality of life of remaining residents....Most importantly for cities facing abandonment problems, the longer a property remains abandoned, the higher the cost of renovation. This leads to continued abandonment even when market conditions have dramatically improved.

Other circumstances that are often cited as contributing to the downward spiral associated with vacant and abandoned properties include systematic delays in State and local land recordation and assessment procedures, as well as the residential foreclosure process, which obscures the identification of property owners or other responsible persons whom the local governments could contact for dealing with the properties. In addition, extra burdens arise when confronting a very large number of vacant and abandoned properties. In sum, local governments need a more efficient and less costly system to expedite the transfer of these problem properties to a responsible person.

Current Tools

Several tools are currently available for local governments in Maryland to utilize to address some of the various problems associated with vacant and abandoned properties. Some local governments may not have local ordinances that make all of these tools available, and many others simply do not have the resources to take advantage of them. As noted in the preliminary conclusion of the October 27, 2016 draft report of the Community Development Network of Maryland, *Summary of Results from Vacant Property Survey*:

Based on the responses [from Baltimore City, 11 counties, and 42 municipalities], it seems clear that municipalities [sic] want more notice and more information to address blight in their areas. While foreclosures are prevalent, some municipalities [sic] are dealing with absentee landlords and investors not taking care of their properties. It is also clear there is not enough capacity in the smaller municipalities [sic] to address the issues head on. It is key that the municipalities [sic] want more tools to address these issues.

Available tools include:

- enforcement of local building, fire, and health codes and nuisance abatement measures;
- registry of vacant properties or registry of properties in foreclosure;

- issuance of certificate of vacancy or certificate of property unfit for human habitation (under Real Property Article 7-105.11, this certificate enables a mortgage lender to omit some of the notice and other requirements in the residential foreclosure process);
- penalty for failure to register a foreclosed property in the FPR maintained by DLLR (under Real Property Article 14-126.1(e)(4), a local law may impose a civil penalty in an amount not exceeding \$1,000 for failure to register);
- tax sale;
- receivership; and
- creation of a land bank (Baltimore City, under Article II of the Baltimore City Charter, and municipalities, under Title 5, Subtitle 4 of the Local Government Article, have authority to establish a land bank that focuses on the conversion of vacant and abandoned property into productive use).

Recent Legislative Activities in Maryland and Other States

Multiple bills introduced over the past several years have sought to address the problems created by foreclosed and vacant properties. For example, House Bill 1377 of 2016 would have (1) required a secured party to immediately begin the foreclosure process for a vacant and abandoned property; (2) required the secured party to maintain vacant and abandoned property under certain circumstances; (3) set certain time limits on the various steps of the foreclosure process; and (4) authorized others to petition a court to require the secured party to meet these standards. House Bill 712 of 2016 would have required Baltimore County to issue a certificate of vacancy or a certificate of property unfit for human habitation for a residential property on request from a secured party if the mortgage or deed of trust on a property is in default.

House Bill 372 of 2015 would have required mortgage lenders to inspect residential properties for evidence of abandonment under specified circumstances. The bill also would have required lenders to maintain abandoned property under specified circumstances and to register the property with a special registry established and maintained by DLLR, much like the current FPR.

Outside of Maryland, states have begun to put in place laws to address their own issues caused by foreclosed or vacant properties. California law requires the legal owner of a vacant, foreclosed residential property to maintain the property and permits a governmental entity to impose a civil fine of up to \$1,000 for failure to maintain the property. In 2014, New Jersey passed a law that provides local governments the authority to fine a mortgage holder for failing to maintain a property. The minimum fine for creditors based in New Jersey is \$1,500 per day and \$2,500 per day for out-of-state creditors. The law also requires out-of-state creditors to designate an individual in New Jersey to manage property maintenance. Earlier this year, Ohio enacted a law that creates an expedited foreclosure process for residential properties that meet three or more indicia of vacant and abandoned property.

Local Government

2017 Legislative Agenda – Maryland Municipal League

The 2017 legislative agenda for the Maryland Municipal League (MML) concerns enhancing local transportation funding, imposing stormwater management fees on government-owned properties, and improving coordination and collaboration on projects in municipal rights-of-way. MML also intends to be strategically engaged on legislation concerning police body cameras and vacant properties.

Legislative Priorities

Highway User Revenues

Most municipalities in Maryland rely upon State shared highway user revenues to maintain and improve public roads within their municipal corporate limits, and more than half of all municipalities rely on police aid to assist in providing law enforcement services. Aside from these two revenue sources, municipal governments in Maryland receive limited State support to finance public services. As a result, most municipal governments in Maryland rely on property taxes and service charges to finance public services. In recent years, Maryland's municipal governments have been subject to reduced State funding resulting from decreases in their share of highway user revenues and police aid to help balance the State's operating budget. Although full funding for police aid was restored in the fiscal 2014 State budget, State support for local roadways has not been fully restored to prior funding levels.

Prior to the reduction in State support in fiscal 2010, municipalities received 2.5% of highway user revenues. In fiscal 2017, the municipal share of highway user revenues totals only 0.4%, resulting in a sharp decline in State funding. Municipalities received \$46.8 million in highway user revenues in fiscal 2007, compared to approximately \$7.4 million in fiscal 2017. However, the fiscal 2014 State budget did include a grant of \$15.4 million to assist municipalities with local transportation projects. State funding for these grants continued for the following three years, with funding totaling \$16.0 million in fiscal 2015 and \$19.0 million in fiscal 2016 and 2017. Even with the grants, the reduction in State funding continues to affect the ability of local governments to provide transportation services within their communities.

The Maryland Municipal League (MML) has adopted, as one of its 2017 legislative priorities, the reinstatement of funding for municipal highway user revenues and the creation of protections to ensure that municipal highway user revenues are not diverted to the State's general fund in the future.

Stormwater Management Fees

The General Assembly first enacted the Stormwater Management Act in 1982 and has amended it several times since. Stormwater management initially focused on urban flood prevention, later evolved into resource management, and, more recently, has become an environmental and regulatory function. Under the Stormwater Management Act, the legislature found that the management of stormwater runoff is necessary to reduce stream channel erosion, pollution, siltation and sedimentation, and local flooding in order to protect the State's water and land resources. The intent of the Stormwater Management Act is to reduce, as much as possible, the adverse effects of stormwater runoff. To achieve that goal, the Act requires each county and municipality to have an ordinance implementing a stormwater management program consistent with flood management plans and that meets certain minimum requirements. A key provision of the Act is the authorization for each county and municipality to adopt a "system of charges" to fund the implementation of stormwater management programs under § 4-204 of the Environment Article; however, State and local governments are exempt from the stormwater charges.

Several bills were introduced in the 2016 legislative session that would have enabled municipalities to charge a stormwater remediation fee to property owned by the State, a unit of State government, a county, or an institution of higher education located within the municipality under certain circumstances; however, none of these bills were enacted. MML has listed as a priority for the 2017 legislative session passage of legislation requiring all governmental entities to pay an applicable municipal stormwater fee on all governmental properties and facilities located within municipal boundaries.

Projects in Municipal Rights-of-way and on Municipal Property

The final legislative priority that MML has adopted for the 2017 legislative session is to support legislation that puts measures in place to ensure better coordination, communication, and collaboration between the State Highway Administration, other governmental agencies, utilities, and municipal officials when scheduling projects within municipal rights-of-way and on other municipally owned property.

Statements of Strategic Engagement

In addition to the three legislative priorities listed above, MML has adopted two statements of strategic engagement. MML supports the use of police body cameras as an effective and transparent law enforcement tool and wants to help shape when cameras are used, how footage is stored, and the release of footage under the Maryland Public Information Act. MML also supports programs that improve transparency and accountability in the foreclosure process and that facilitate the process of addressing vacant properties created both by foreclosure and owner neglect.

Local Government

2017 Legislative Agenda – Maryland Association of Counties

The Maryland Association of Counties has four legislative priorities for the 2017 session, three of which are ongoing efforts from the prior year. Ongoing priorities include the reinvestment in local transportation projects, enhanced State funding for school construction, and legal issues surrounding the use of body-worn cameras by local law enforcement officers. A new priority centers on the adherence to local land use requirements for dispersed energy generation facilities.

Reinvestment in Local Roads, Bridges, and Infrastructure

The Maryland Association of Counties (MACo) continues to promote as one of its priorities for the 2017 session the reinvestment by the State in local transportation structures such as roads and bridges. In addition, MACo includes other infrastructure needs this year as well, indicating that all these various types of infrastructure have suffered from recession-driven cost shifts and neglect. Besides local roadways and bridges, other priorities identified by MACo that need predictable, centralized funding include school maintenance, water delivery systems, and public safety centers. MACo maintains that reinvesting in infrastructure is good for Maryland jobs, business attractiveness, and quality of life across the State. More specifically, MACo urges the General Assembly to:

- approve meaningful new funding in fiscal 2018 for restoring highway user revenues, using the statewide formula that has been used for decades;
- enact a phased-in restoration of the historic 30% local share of State transportation revenues, so as to enhance safety and road quality for motorists traveling throughout the State; and
- require the assessment and documentation of the condition of public infrastructure across the State, so as to evaluate the needs and appropriate dedicated revenue sources for each area of service.

Strong and Smart Funding for School Construction

MACo continues to maintain that the State's commitment to school construction funding needs to remain strong and smart to best serve the modern needs of schoolchildren, educators, and communities. MACo contends that strong State funding will recognize modern costs in order to achieve new environmental and energy standards, satisfy heightened needs for technology, ensure student safety, fulfill community resource needs, and mesh with evolving teaching methods. Smart State funding will provide flexibility for seeking cost-effective solutions to meet student and community school construction needs. Accordingly, MACo proposes that the General Assembly adopt a strong and smart school construction funding program that:

- reduces unnecessary regulation;
- revises processes to work alongside county budget decisions;
- provides a county voice in State school construction funding decisions;
- promotes statewide and regional efficiencies; and
- provides a meaningful opportunity to pursue alternative financing for school construction.

Access to Footage of Body-worn Cameras of Local Law Enforcement Officers

MACo recognizes the growing trend by law enforcement agencies to deploy body-worn cameras (BWC) by their law enforcement officers. However, because this movement involves a myriad of complex legal issues and is still in its early stages in most parts of the country, MACo again urges careful consideration by the legislature of the issue of access to BWC footage under the Maryland Public Information Act (PIA). MACo contends that since the PIA was created primarily to handle paper documents and only recently has accommodated electronic records, the PIA still does not adequately address the practical, technical, and privacy challenges facing a local government with requests for access to potentially hundreds of hours of BWC footage. Therefore, MACo supports legislation that strikes a reasonable balance between open and transparent access to BWC footage while minimizing the burdens on local governments with overbroad, abusive, or invasive requests.

Local Land Use Requirements for Dispersed Energy Generation Facilities

This interim, MACo has been actively engaged in recent developments concerning the approval process for the siting of dispersed energy generation facilities across the State. MACo explains that applications for traditional energy generation facilities (such as coal, oil, or nuclear power plants), as well as transmission lines, are more appropriate for approval by the Public Service Commission, rather than the counties that usually handle land use decisions, because these facilities require significant space and infrastructure, and come with publically perceived disadvantages that all but guarantee a “not in my backyard” response, regardless of where they may be placed. However, as for applications for more modern utility-scale/output-to-grid facilities (such as wind, solar, gasification, or anaerobic digestion power plants), MACo contends that local land use requirements should not be preempted by the State. These more modern facilities can often be located in smaller spaces, do not need additional infrastructure, and can be “dispersed” anywhere there is suitable land, often in agricultural or open space areas. MACo maintains that the cumulative effect of multiple dispersed facilities on a county can be far more significant than one traditional facility. In addition to participating this interim in a series of Maryland Land and Energy Caucus meetings with other public and private stakeholders, MACo has submitted comments to the Public Service Commission regarding land use preemption by a solar energy farm in Kent County. In light of these developments, MACo urges adherence to local land use regulations for the approval of dispersed energy generation facilities.