

**Y01A
State Reserve Fund**

Operating Budget Data

(\$ in Thousands)

	<u>FY 17 Actual</u>	<u>FY 18 Working</u>	<u>FY 19 Allowance</u>	<u>FY 18-19 Change</u>	<u>% Change Prior Year</u>
General Fund	\$155,377	\$10,000	\$267,345	\$257,345	2,573.5%
Adjustments	0	0	-258,000	-258,000	
Adjusted General Fund	\$155,377	\$10,000	\$9,345	-\$655	-6.5%
Adjusted Grand Total	\$155,377	\$10,000	\$9,345	-\$655	-6.5%

Note: FY 18 Working includes targeted reversions, deficiencies, and across-the-board reductions. FY 19 Allowance includes contingent reductions and cost-of-living adjustments.

- The Governor’s proposed fiscal 2019 budget totals \$9.3 million, which provides \$3.3 million for the Revenue Stabilization Account (Rainy Day Fund) and \$6 million for Program Open Space (POS) critical maintenance projects.
- The Budget Reconciliation and Financing Act (BRFA) of 2018 proposes to reduce the statutorily required contribution to the Rainy Day Fund by \$193 million, the State employees’ pension fund by \$50 million, and POS by \$15 million.

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

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Analysis in Brief

Major Trends

Rainy Day Fund Balance Remains at 5% of Revenues for the Twelfth Consecutive Year: If the fund balance is below 7.5%, the Governor is required to appropriate at least \$50 million into the fund. The BRFA of 2018 proposes to reduce the fiscal 2019 appropriation by \$193 million in conjunction with a contingent reduction in the budget bill, leaving a \$3.3 million appropriation.

Issues

Overview of General Fund Revenue Volatility Legislation Enacted in 2017: The 2016 *Joint Chairmen’s Report* required that the Department of Budget and Management (DBM), the Comptroller of Maryland, and the Department of Legislative Services (DLS) examine the volatility of Maryland’s revenue structure and recommend an approach to reducing volatility. The report recommended that some statutory changes be made to revenue forecasting and the Rainy Day Fund. Specifically, all three agencies’ recommended that there be a cap on nonwithholding revenues and that there be a requirement to appropriate funds into the Rainy Day Fund if the balance is below 10% of general fund revenues. Chapters 4 and 550 of 2017 codified key recommendations of the report. **To ease the transition into the income tax nonwithholding cap, DLS recommends that the BRFA of 2018 amend subsection 6-104 (e) of the State Finance and Procurement Article so that the maximum cap is limited to 0.5% of general fund revenues in fiscal 2020, 1% in fiscal 2021, and 2% in fiscal 2022.**

Update on Unfunded Liabilities in the Local Income Tax Reserve Account: The State maintains a Local Income Tax Reserve Account. The State collects income taxes for local jurisdictions and makes payments to the counties and Baltimore City from this account. According to generally accepted accounting principles, the State is supposed to maintain a sufficient fund balance to pay future refunds realized during the fiscal year in case the income tax is no longer collected. In recent year, funds have been transferred out of the Local Income Tax Reserve Account so that the account now has a \$716.8 million unfunded liability. **The department should brief the committees on plans, if any, to reduce the unfunded liability in the Local Income Tax Reserve Account.**

Status of Neighborhood BusinessWorks Program Loan Repayments to the Catastrophic Event Account: In July 2016, the Patapsco River waters rose after heavy rains and flooded Ellicott City, damaging many businesses and homes. In response, the Administration proposed to help Ellicott City recover by transferring \$2.5 million from the Catastrophic Event Account into the Department of Housing and Community Development’s (DHCD) Neighborhood BusinessWorks program to provide loans to businesses. The General Assembly expressed the intent that loan recipient repayments be directed to the Catastrophic Event Account and not retained in DHCD revolving loan funds. Budget bill language was adopted to require that DHCD submit a report to the budget committees that lists the number and amount of loans provided, the outstanding balance of these loans, and the number and amount of any forgiven loans. DHCD is making quarterly payments to the Catastrophic Event

Account. **DLS recommends that the budget committees again adopt annual language requiring DBM, in consultation with DHCD, to submit a report providing the aggregate status of all outstanding loans and the status of current and proposed repayments to the Catastrophic Event Account and the Small, Minority, and Women-Owned Businesses Account.**

Catastrophic Event Account Transfer to Support Repairs to Baltimore City Public Schools: In January 2018, the Administration processed a budget amendment to transfer \$2.5 million from the Catastrophic Event Account to the Department of General Services to provide grants for Baltimore City Public School’s heating, ventilation, and air conditioning repairs. The General Assembly was not provided with an opportunity to review and comment on the proposal despite statutory language requesting an opportunity to review and approve. **To provide an opportunity to review and comment on budget amendment transfers from the Catastrophic Event Account, DLS recommends that the BRFA of 2018 be amended to allow the Legislative Policy Committee up to a 15-day review and comment period.**

Operating Budget Recommended Actions

1. Add a section requiring the Department Budget and Management and the Department of Housing and Community Development to report on a Catastrophic Event Account and Small, Minority, and Women-Owned Businesses Account repayment plan.

Budget Reconciliation and Financing Act Recommended Actions

1. To ease the transition into the income tax nonwithholding cap, the Department of Legislative Services recommends that the Budget Reconciliation and Financing Act of 2018 amend subsection 6-104 (e) of the State Finance and Procurement Article so that the maximum cap is limited to 0.5% of general fund revenues in fiscal 2020, 1% in fiscal 2021, and 2% in fiscal 2022.
2. To provide an opportunity to review and comment on budget amendment transfers from the Catastrophic Event Account to State agencies, the Department of Legislative Services (DLS) recommends that the Budget Reconciliation and Financing Act of 2018 be amended to allow the Legislative Policy Committee a 15-day review and comment period. DLS also recommends that the Dedicated Purpose Account’s statutes also be amended to allow up to a 45-day review and comment period.
3. The State’s Local Income Tax Reserve Account has an unfunded liability totaling \$717 million. **To reduce this unfunded liability, the Department of Legislative Services recommends that the Budget Reconciliation and Financing Act of 2018 be amended to continue the annual \$10 million repayment into the Local Income Tax Reserve Account indefinitely.**

Y01A – State Reserve Fund

Y01A
State Reserve Fund

Operating Budget Analysis

Program Description

The State Reserve Fund provides a means to designate monies for future use. It comprises four individual accounts:

- Revenue Stabilization Account (Rainy Day Fund);
- Dedicated Purpose Account (DPA);
- Catastrophic Event Account; and
- Economic Development Opportunities Account (Sunny Day Fund).

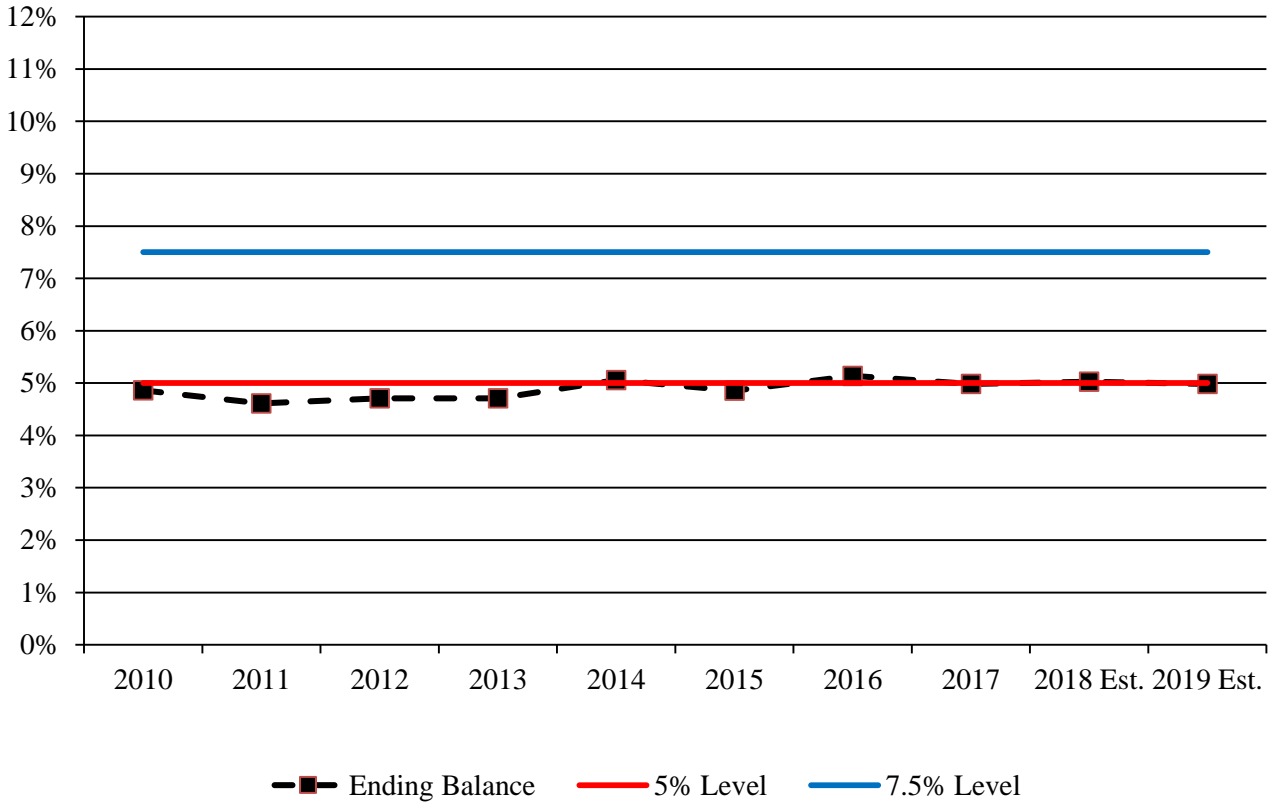
The purpose and status of the first three of these accounts are discussed in more detail in this analysis. Discussion of the Sunny Day Fund can be found in the analysis of the Department of Commerce.

Performance Analysis: Managing for Results

1. Rainy Day Fund Balance Remains at 5% of Revenues for the Twelfth Consecutive Year

Section 7-311 of the State Finance and Procurement Article establishes a target reserve balance of 7.5% of estimated general fund revenues. The State last was materially above 5% in fiscal 2007 when the Rainy Day Fund ended with a balance in excess of 11% of general fund revenue. This was before the Great Recession, which began in December 2007. In fiscal 2008, the State transferred \$978 million from the Rainy Day Fund to the General Fund, which reduced the balance to 5%. **Exhibit 1** shows that the State has not made any progress toward increasing the fund balance above 5%.

Exhibit 1
Rainy Day Fund End-of-year Balances
Fiscal 2010-2019 Est.



Source: Department of Budget and Management, January 2018

Proposed Budget

Exhibit 2 shows that the fiscal 2019 allowance is \$9.3 million, which is \$0.7 million less than the fiscal 2018 appropriation. The allowance includes three statutorily required appropriations. Two relate to a “sweeper” to support the Rainy Day Fund and State employee pensions, and the third is a required repayment to Program Open Space (POS) for prior year POS fund transfers into the General Fund.

**Exhibit 2
Proposed Budget
State Reserve Fund
(\$ in Thousands)**

How Much It Grows:	General Fund	Total
Fiscal 2017 Actual	\$155,377	\$155,377
Fiscal 2018 Working Appropriation	10,000	10,000
Fiscal 2019 Allowance	<u>9,345</u>	<u>9,345</u>
Fiscal 2018-2019 Amount Change	-\$655	-\$655
Fiscal 2018-2019 Percent Change	-6.5%	-6.5%
 Where It Goes:		
Rainy Day Fund		
Remove fiscal 2018 Rainy Day Fund appropriation		-\$10,000
Statutorily required appropriation: Rainy Day Fund sweeper		196,345
Contingent reduction: Reduce appropriations and maintain Rainy Day Fund balance at 5% of general fund revenues		-193,000
Dedicated Purpose Account		
Statutorily required appropriation: Pension sweeper.....		50,000
Contingent reduction: Delete pension sweeper		-50,000
Statutorily required appropriation: Program Open Space repayment.....		21,000
Contingent reduction: Reduce Program Open Space repayment.....		-15,000
Total		-\$655

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

Since fiscal 2000, the State’s sweeper requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of \$10 million into the Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. The Budget Reconciliation and Financing Act (BRFA) of 2015 (Chapter 489) amended the

Y01A – State Reserve Fund

sweeper requirement so that the Rainy Day Fund receives only 50% of any unassigned general fund surplus for fiscal 2017 to 2020. The other 50% is appropriated to reduce the State's unfunded pension liability. The pension appropriation is capped at \$50 million.

Chapter 10 of 2016 requires that \$237 million of transfer tax revenues redirected to the General Fund by fiscal 2019 be reimbursed to POS. In fiscal 2019, this requires that a \$15 million repayment to the transfer tax be distributed through the transfer tax formula and \$6 million to critical maintenance projects at State parks.

Fiscal 2017 ended with an unassigned balance totaling \$256.3 million. After deducting \$10 million, per law, this leaves a \$246.3 million unassigned balance. Of this amount, \$196.3 million is to be appropriated in fiscal 2019 to the Rainy Day Fund, and \$50 million is to be appropriated in fiscal 2019 for State pension payments. The allowance also includes \$21 million for POS.

The Administration's budget plan proposes to cancel most of these statutory appropriations. SB 187/HB 161 include \$258 million in contingent reductions. Specific reductions are:

- \$193 million of the \$196.3 million Rainy Day Fund sweeper appropriation, leaving \$3.3 million;
- \$50 million to eliminate the pension sweeper; and
- \$15 million of the POS repayment leaving \$6 million to support POS critical maintenance projects.

Exhibit 3 provides an overview of State Reserve Fund activity between fiscal 2017 and 2018. Detail for each account may be found in **Appendix 4** (Rainy Day Fund), **Appendix 5** (DPA), and **Appendix 6** (Catastrophic Event Account).

Exhibit 3
State Reserve Fund Activity
Fiscal 2018-2019
(\$ in Millions)

	<u>Rainy Day Fund</u>	<u>Dedicated Purpose Acct.</u>	<u>Catastrophic Event Acct.</u>
Estimated Balances 6/30/17	\$832.5	\$0.0	\$7.2
Fiscal 2018 Appropriations	10.0	0.0	0.0
Interest Earnings	16.0	0.0	0.0
DHCD BusinessWorks Loan Repayment ¹	0.0	0.0	0.1
Baltimore City Schools HVAC Repairs	0.0	0.0	-2.5
Estimated Balances 6/30/18	\$858.5	\$0.0	\$4.8
Fiscal 2019 Appropriations	196.3	71.0	0.0
Contingent Reduction	-193.0	-65.0	0.0
Interest Earnings	20.7	0.0	0.0
Transfer to Program Open Space	0.0	-6.0	0.0
Estimated Balances 6/30/19	\$882.5	\$0.0	\$4.8
Percent of Revenues in Reserve	5.0%		

DHCD: Department of Housing and Community Development
 HVAC: heating, ventilation, and air conditioning

¹ Additional repayments anticipated.

Source: Department of Budget and Management, January 2018

Issues

1. Overview of General Fund Revenue Volatility Legislation Enacted in 2017

Due to the business cycle, revenue volatility is unavoidable for State governments. States that rely heavily on highly volatile revenue sources like capital gains to fund ongoing spending are especially vulnerable to the vagaries of the economy. Minimizing reliance on unstable revenue sources can help states soften the impact of recessions and avoid building unsustainable ongoing spending into their budgets during economic booms. In recent years, a number of states have adopted or considered changes to their revenue forecasting and budgetary practices to reduce their vulnerability to revenue volatility.

The 2016 *Joint Chairmen’s Report* required that the Department of Budget and Management, (DBM), the Comptroller of Maryland, and the Department of Legislative Services (DLS) examine the volatility of Maryland’s revenue structure and recommend an approach to reducing volatility. The report was submitted in November 2016. It recommended that some statutory changes be made to revenue forecasting and the Rainy Day Fund. Specifically, all three agencies recommended that there be a cap on income tax nonwithholding revenues and that there be a requirement to appropriate funds into the Rainy Day Fund if the balance is below 10% of general fund revenues.

Legislation to Cap Income Tax Nonwithholding Revenues to Dedicate Funds for Reserves and Capital Projects Is Enacted

Chapters 4 and 550 of 2017 codify key recommendations of the report. The legislation provides for a methodology to estimate excess income tax nonwithholding, increase Rainy Day Fund balances, and determine how excess funds are appropriated. The legislation establishes a cap on income tax nonwithholding revenues based on the 10-year average of income tax nonwithholding revenues. In some years, actual income tax nonwithholding revenues will exceed the capped revenues that were budgeted.

Use of Income Tax Nonwithholding Income Tax Revenues

Beginning with fiscal 2020, if actual income tax nonwithholding income tax revenues exceed the cap, the amount of income tax nonwithholding revenues that exceed the capped estimate must be applied as follows:

- the first priority is to close the revenue gap for that fiscal year so that funds must be used to close any budget deficit;
- if the available nonwithholding income tax revenues exceed the amount that is needed to close the gap (or there is no budget deficit), the Comptroller must distribute any remaining amount to the Rainy Day Fund;

Y01A – State Reserve Fund

- if the Rainy Day Fund balance is equal to or exceeds 6% of estimated general fund revenues, the Comptroller must distribute 50% of any remaining amount to the Rainy Day Fund and the other 50% into the Fiscal Responsibility Fund; and
- if the Rainy Day Fund balance exceeds 10% of estimated general fund revenues, any remainder must be distributed to the Fiscal Responsibility Fund.

Establishment of the Fiscal Responsibility Fund

The bill establishes a special, nonlapsing Fiscal Responsibility Fund to provide supplemental pay-as-you-go (PAYGO) capital funds for public school construction, public school capital improvement projects, capital projects at public community colleges, and capital projects at four-year public institutions of higher education. The Governor must include, in the budget bill for the second following fiscal year, an appropriation equal to the amount in the fund for PAYGO capital projects.

Example of the Effect of the Cap on Fiscal 2019

Although the law does not require that the State apply the cap until fiscal 2020, DLS has prepared an example of how the law would be implemented using fiscal 2019 revenue estimates. **Exhibit 4** shows that total fiscal 2019 general fund revenues are estimated to be \$17,625 million of which income tax nonwithholding revenues total \$2,644 million. Since the income tax nonwithholding revenues have averaged 13.65% of total general fund revenues over the last 10 years, income tax nonwithholding is capped at \$2,406 million. Applying the 10-year average to total revenues results in an income tax nonwithholding cap of \$276 million. The law also limits the cap to 2% of total general fund revenues. In fiscal 2019, this limits the cap to \$352 million. Since the cap is less than \$352 million, this limit has no effect. To apply the cap when preparing the balanced budget, the Board of Revenue Estimates would reduce income tax nonwithholding revenues by \$276 million.

Based on the current out-year revenue forecast, the cap would result in a similar amount of revenue being reduced from the estimate in fiscal 2020 and in each of the subsequent three years. By statute, fiscal 2020 is the first year that the cap will apply. The current revenue forecast assumes growth in general fund revenues before applying the cap of \$514 million. Applying the cap would eliminate more than half of the projected revenue growth. The impact of the cap is especially acute in fiscal 2020 because it is the first time the cap is applied. Nonwithholding revenues represent a similar share of the general fund revenues in both fiscal 2019 and 2020, but the cap does not go into effect until fiscal 2020. Phasing the cap in over a multi-year period would minimize the shock that results from going from an uncapped environment to a capped environment.

Exhibit 4 also provides examples of the effect of reducing the limit on the cap to 1% and 0.5% of general fund revenues. Limiting the maximum cap to 1% of general fund revenues results in a \$176 million cap, and limiting the cap to 0.5% of general fund revenues results in an \$88 million cap.

When implementing major changes in spending policy, it is common practice for the State to phase in a new policy. By phasing in the cap, the State could limit some of the cap's short-term effects

as it moves from no cap to a 2% cap. To ease the transition into the income tax nonwithholding cap, DLS recommends that the BRFA of 2018 amend subsection 6-104 (e) of the State Finance and Procurement Article so that the maximum cap is limited to 0.5% in fiscal 2020, 1% in fiscal 2021, and 2% in fiscal 2022.

Exhibit 4
Example of Income Tax Nonwithholding Cap with Limits
Fiscal 2019

	With 2% Maximum Cap	With 1% Maximum Cap	With 0.5% Maximum Cap
December 2018 General Fund Revenue Estimate			
Total General Funds	\$17,625	\$17,625	\$17,625
State Income Tax Nonwithholding Revenues	2,644	2,644	2,644
Share to Total General Funds	15.00%	15.00%	15.00%
Income Tax Nonwithholding Limit			
10-year Average: Income Tax Nonwithholding Share of Total General Fund Revenues	13.65%	13.65%	13.65%
State Income Tax Nonwithholding Cap	\$2,406	\$2,406	\$2,406
Cap Adjustment Calculation			
State Income Tax Nonwithholding Cap	\$2,406	\$2,406	\$2,406
State Income Tax Nonwithholding Estimate	2,644	2,644	2,644
Preliminary Adjustment (Cap – Estimate)	-276	-276	-276
Maximum Test: Percent of General Fund Revenues	2.00%	1.00%	0.50%
Maximum Income Tax Nonwithholding Cap	-\$352	-\$176	-\$88
Final General Fund Revenue Adjustment	-\$276	-\$176	-\$88

Note: Current law limits the cap to 2% of total general fund revenues. Columns limiting the cap to 1% and 0.5% are presented for illustrative purposes.

Source: State Comptroller's Office

2. Update on Unfunded Liabilities in the Local Income Tax Reserve Account

The State maintains a Local Income Tax Reserve Account. The State collects income taxes for local jurisdictions and makes payments to the counties and Baltimore City from this account. According to generally accepted accounting principles, the State is supposed to maintain a sufficient fund balance to pay future refunds realized during the fiscal year, in case the income tax is no longer collected. If the account is insufficiently capitalized at the end of a fiscal year, the State is required to report the underfunding as an unfunded liability in the *Comprehensive Annual Financial Report* (CAFR). If the State has a plan in place to reimburse the account, the State does not need to show an unfunded liability in the CAFR. This is a concern because the State has transferred funds from this account to support general fund spending.

To fund the State budget, the following actions have transferred funds out of this account:

- \$366.8 million was transferred in fiscal 2009 to support operating budget spending. The Comptroller’s Office advises that this is attributable to the State having deposited more State funds on behalf of local jurisdictions than was necessary. As such, the Comptroller’s Office classifies this as a local liability. When the transfer was made, Chapter 487 (the BRFA of 2009) required that local jurisdictions reimburse the account. Chapter 1 of the first special session of 2012 (BRFA) repealed the repayment requirement;
- \$350 million to the Education Trust Fund. Chapter 484 (the BRFA of 2010) required that this amount be repaid in \$50 million increments from fiscal 2014 through 2020. Chapter 425 (the BRFA of 2013) repealed the repayment requirement;
- \$200 million for Medicaid. Chapter 484 required that this amount be repaid from fiscal 2021 through 2026 at \$33.3 million per year; and
- \$100 million was transferred to the General Fund in fiscal 2015. Chapter 489 required that \$10 million will be reimbursed each year, beginning in fiscal 2016, with a final payment in fiscal 2025. The reimbursement is not appropriated; instead, the portion of personal income tax net receipts deposited into the reserve account will be increased to provide an additional \$10 million annually.

Insofar as there is no repayment plan for the \$366.8 million that was transferred in fiscal 2009 and no repayment plan for the \$350 million that was transferred in fiscal 2011, the total unfunded liability is \$716.8 million. The State reports these unfunded liabilities in the CAFR.¹ **Exhibit 5** summarizes actions taken since fiscal 2009.

¹ Page 77 of the fiscal 2017 *Comprehensive Annual Financial Report* notes that there is a plan to reimburse \$200 million from fiscal 2021 to 2026 and \$100 million reimbursed through fiscal 2025. The note mentions that no dates are specified to reimburse the remaining balance.

Exhibit 5
Local Income Tax Reserve Account Transfers
Fiscal 2009-2026
(\$ in Millions)

Transfers	Amount
Fiscal 2009 General Fund transfer that the State forgave, but it still is a local liability	\$366.8
Fiscal 2010 Education Trust Fund transfer	350.0
Fiscal 2011 Medicaid transfer	200.0
Fiscal 2015 General Fund transfer	100.0
Payments made in fiscal 2016 and 2017 to reimburse fiscal 2015 transfer (these are first of 10 annual payments)	-20.0
Total Liability at close of fiscal 2017	\$996.8
Anticipated Reimbursements	Amount
Transfers to reimburse Medicaid transfer, \$33.3 million annually from fiscal 2021 to 2026	\$200.0
Remaining payments made from fiscal 2018 and 2025 to reimburse fiscal 2015 transfer (this is 10 annual payments, with 8 to go)	80.0
Total Anticipated Reimbursements	\$280.0
Unfunded Liability	\$716.8

Sources: Comptroller’s Office; Department of Legislative Services, 2009, 2010, and 2011 *The 90 Day Report*

Credit rating agencies are aware of this liability and have commented about it in ratings reports. For example, before the July 2014 bond sale, Moody’s noted that the State has “thin available balances,” which it attributes to “the state’s transfer of local income tax reserves for budget balancing purposes in fiscal 2009 and 2011.” More recently, Moody’s has acknowledged that cash balances have increased but that they still evaluate these transfers and the unfunded liability when reviewing State general obligation bonds’ credit rating.

In past recessions, funds have been transferred to the General Fund and then reimbursed when the recession ended. **DLS recommends that the BRFA of 2018 be amended to continue the annual \$10 million repayment into the Local Income Tax Reserve Account indefinitely. The department should brief the committees on plans, if any, to reduce the unfunded liability in the Local Income Tax Reserve Account.**

3. Status of Neighborhood BusinessWorks Program Loan Repayments to the Catastrophic Event Account

In July 2016, the Patapsco River waters rose after heavy rains and flooded Ellicott City. The flood damaged many businesses and homes. In response, the Administration proposed to help Ellicott City recover. This included providing loans for businesses to rebuild.

Budget Amendment 011-17 transferred \$2.5 million from the Catastrophic Event Account into the Department of Housing and Community Development's (DHCD) Neighborhood BusinessWorks program to provide loans to businesses. As required by State law, the Legislative Policy Committee (LPC) reviewed and approved the amendment. As part of its review, LPC concurred with DLS' recommendation that DHCD develop a process by which the funds or repaid loans are deposited into the Catastrophic Event Account.

The General Assembly adopted budget bill language requiring that DHCD submit a report to the budget committees that provides data regarding the number and amount of loans provided, the outstanding balance of these loans, and the number and amount of any forgiven loans. This report should be submitted to the budget committees by January 1, 2018.

DHCD reported that it encumbered the entire \$2.5 million of which \$2.1 million has been disbursed. **Exhibit 6** shows that borrowers have repaid approximately \$611,000, which is 28.9% of the outstanding balance. To date, no loans have been forgiven. Each quarter, DHCD is transferring proceeds from repaid loans into the Catastrophic Event Account. DHCD has transferred \$328,000 in repayments to DBM to be transferred into the Catastrophic Event Account. These quarterly payments are anticipated to continue until the full amount is returned to the account. As of January 2018, reports from the Comptroller's Office show that approximately \$222,000 has been transferred into the Catastrophic Event Account. **DBM should be prepared to brief the committee on debt repayment cash flows and the timing of the quarterly repayment. DBM should also be prepared to brief the committees on processes in place to transfer repayments into the Catastrophic Event Account. DLS also recommends that the budget committees adopt annual language requiring DBM, in consultation with DHCD, to submit a report providing the aggregate status of all outstanding loans and the status of current and proposed repayments to the Catastrophic Event Account and the Small, Minority, and Women-Owned Businesses Account by January 22, 2019.**

Exhibit 6
Use and Repayment of Catastrophic Event Account Transfer to
BusinessWorks Program
August 2016 to December 2017
(\$ in Thousands)

Fund Sources

Amount Disbursed	\$2,119
Undisbursed Amount	381
Total Transfer from the Catastrophic Event Account	\$2,500

Repayment to Department of Housing and Community Development

Debt Repaid by Borrowers to the Department of Housing and Community Development	\$611
Amount to be Repaid	1,508
Undisbursed Amount	381
Total Repayments	\$2,500

Repayment to Catastrophic Event Account

Repaid as of January 1, 2018	\$328 ¹
Amount to be Reimbursed	2,172
Total Repayments	\$2,500

¹ Only \$222,284 has been deposited as of January 1, 2018.

Source: Department of Housing and Community Development; Department of Budget and Management

4. Catastrophic Event Account Transfer to Support Repairs to Baltimore City Public Schools

In a letter dated January 8, 2018, the Governor notified the Senate President and the Speaker of the House that Budget Amendment 034-18 transfers \$2.5 million from the Catastrophic Event Account to the Department of General Services (DGS). The purpose of the amendment is for DGS to provide grants to Baltimore City schools to support the cost of repairs to heating, ventilation, and air conditioning (HVAC) systems. The budget amendment noted that the funds are needed immediately “to address Baltimore City Schools with failing HVAC systems” and that “funds not disbursed by June 30, 2018 will be returned to the Catastrophic Event Account.”

Y01A – State Reserve Fund

In a letter dated January 16, 2018, the President of the Senate and the Speaker of the House requested that the Administration increase funding for HVAC improvements to \$5 million so that grants can be provided to other jurisdictions. At the time that this analysis went to print, the Administration has not committed to this funding increase.

The Catastrophic Event Account is in Section 7–324 of the State Finance and Procurement Article. The law provides that “[A]fter notice to and approval by the Legislative Policy Committee, the Governor may transfer funds by budget amendment from the Account to the expenditure accounts of the appropriate unit of State government.” According to advice from the Attorney General’s Office, approval by LPC is a legislative veto, which is unconstitutional. As such, the Administration merely needs to provide notice to the committee. This process does not provide any opportunity for the General Assembly to review and comment about fund transfers out of the Catastrophic Event Account.

The Attorney General’s Office advises that State law can be amended so that the General Assembly has an opportunity to review and comment prior to transfers from the Catastrophic Event Account to State agencies. This requires amendments to subsection 7-324 (d) of the State Finance and Procurement Article. The budget committees have routinely restricted funds in the budget pending 45 days review and comment. Often, this comment is provided well before 45 days. **To provide an opportunity to review and comment on budget amendment transfers from the Catastrophic Event Account to State agencies, DLS recommends that the BRFA of 2018 be amended to allow LPC up to a 15-day review and comment period. DLS recommends that the DPA statutes be amended to allow up to a 45-day review and comment period.**

Operating Budget Recommended Actions

1. Add the following section:

Section ____ Repayment of Catastrophic Event Account and Small, Minority, and Women-Owned Businesses Account

SECTION XX. AND BE IT FURTHER ENACTED, That \$100,000 of the general fund appropriation for the Department of Budget and Management (DBM) Executive Direction program F10A01.01 and \$100,000 for the special fund appropriation for the Department of Housing and Community Development (DHCD) Office of the Secretary program S00A20.01 made for the purpose of operations may not be expended until DBM, in consultation with DHCD, submits a report to the budget committees on the balance of outstanding loans and current and proposed repayment for loans made by the DHCD’s Neighborhood BusinessWorks program for the purposes of Ellicott City flood recovery efforts. It is the intent of the budget committees that DHCD repay the Catastrophic Event Account for \$2,500,000 transferred from the account to DHCD, and that DHCD repay the Small, Minority, and Women-Owned Businesses Account for \$2,312,500 transferred from the account to DHCD. The report shall be submitted by January 22, 2019, and the budget committees shall have 45 days to review and comment. Funds restricted pending the receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund or be canceled if the report is not submitted to the budget committees.

Explanation: In September 2016, \$2.5 million was transferred from the Catastrophic Event Account, and \$0.6 million was transferred from the Small, Minority, and Women-Owned Businesses Account into the DHCD Neighborhood BusinessWorks program to provide loans to businesses in Ellicott City. As part of its review of the transfer of funds from the Catastrophic Event Account, the Legislative Policy Committee recommended that DHCD develop a process by which the funds or repaid loans are deposited into the Catastrophic Event Account. The department should submit a report that provides data regarding the number and amount of loans provided, the outstanding balance of these loans, and the number and amount of any forgiven loans. This report should be submitted to the budget committees by January 22, 2019.

Information Request	Authors	Due Date
Report on Catastrophic Event Account and Small, Minority, and Women-Owned Businesses Account repayment	DHCD DBM	January 22, 2019

Y01A – State Reserve Fund

**Appendix 1
Current and Prior Year Budgets
State Reserve Fund
(\$ in Thousands)**

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2017					
Legislative Appropriation	\$235,336	\$0	\$0	\$0	\$235,336
Deficiency Appropriation	0	0	0	0	0
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	-79,959	0	0	0	-79,959
Actual Expenditures	\$155,377	\$0	\$0	\$0	\$155,377
Fiscal 2018					
Legislative Appropriation	\$10,000	\$0	\$0	\$0	\$10,000
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Working Appropriation	\$10,000	\$0	\$0	\$0	\$10,000

Note: The fiscal 2018 appropriation does not include deficiencies, targeted reversions, or across-the-board reductions. Numbers may not sum to total due to rounding.

Fiscal 2017

The fiscal 2017 appropriation totaled \$235.3 million. The General Assembly amended the bill to restrict \$80 million for other purposes. The restriction required the Administration to either fund all of the priorities or the funds would revert to the General Fund. The Governor did not fund any of these programs, so the entire \$80 million reverted to the General Fund at the end of fiscal 2017. **Appendix 3** shows what programs were funded.

Fiscal 2018

The fiscal 2018 appropriation totals \$10 million. To date, there have not been any cost containment reductions or budget amendments. The funds are expected to remain in the Revenue Stabilization Account through the end of fiscal 2018.

**Appendix 2
Fiscal Summary
State Reserve Fund**

<u>Program/Unit</u>	<u>FY 17 Actual</u>	<u>FY 18 Wrk Approp</u>	<u>FY 19 Allowance</u>	<u>Change</u>	<u>FY 18 - FY 19 % Change</u>
01 Revenue Stabilization Account	\$ 155,376,558	\$ 10,000,000	\$ 196,345,241	\$ 186,345,241	1863.5%
02 Dedicated Purpose Account	0	0	71,000,000	71,000,000	0%
Total Expenditures	\$ 155,376,558	\$ 10,000,000	\$ 267,345,241	\$ 257,345,241	2573.5%
General Fund	\$ 155,376,558	\$ 10,000,000	\$ 267,345,241	\$ 257,345,241	2573.5%
Total Appropriations	\$ 155,376,558	\$ 10,000,000	\$ 267,345,241	\$ 257,345,241	2573.5%

Note: The fiscal 2018 appropriation does not include deficiencies, targeted reversions, or across-the-board reductions. The fiscal 2019 allowance does not include contingent reductions or cost-of-living adjustments

Appendix 3
Rainy Day Fund Appropriations Restricted for Other Purposes
Fiscal 2017

<u>Program</u>	<u>Amount</u>
<i>Program R00A02.03 Aid for Local Employee Fringe Benefits:</i> To provide additional one-time funding to local education agencies to support a portion of their share of the actual normal cost of pensions for their teachers.	\$18,999
<i>Program M00Q01.03 Medical Care Provider Reimbursements:</i> To increase primary and specialty physician evaluation and management rates to 96% of Medicare.	13,200
<i>Program M00Q01.10 Medicaid Behavioral Health Provider Reimbursements:</i> To increase psychiatrist evaluation and management rates to 96% of Medicare.	880
<i>Program M00Q01.03 Medical Care Provider Reimbursements:</i> To increase funding over that provided in the fiscal 2017 budget to the Baltimore City Health Department for the Administrative Care Coordination Unit.	500
<i>Program M00Q01.03 Medical Care Provider Reimbursements:</i> For lead remediation activities in the homes of Medicaid children with a confirmed elevated blood lead level of over 10 micrograms/deciliter.	500
<i>Facilities Renewal Fund:</i> To provide funds for the repair and rehabilitation of State-owned capital facilities (statewide).	15,000
<i>Aging Schools Program:</i> To provide additional grants for capital improvements, repairs, and deferred maintenance work at existing public school buildings.	6,109
<i>Public Safety Communication System:</i> To provide funds to continue to design, construct, and equip a statewide unified public safety communication.	9,190
<i>Demolition of Buildings at the Baltimore City Correctional Complex:</i> To provide funds to begin design and demolition of the buildings at the Baltimore City Correctional Complex.	6,581
<i>Maryland Agricultural Cost-Share Program:</i> To provide funds for financial assistance for the implementation of best management practices that reduce soil and nutrient runoff from Maryland farms.	6,000
<i>Program N00G00.08 Assistance Payments:</i> To provide funds to support a State supplement to the Food Supplement Program.	1,000
<i>National Great Blacks in Wax Museum</i>	200

Y01A – State Reserve Fund

<u>Program</u>	<u>Amount</u>
<i>Maryland Business Roundtable on Education</i>	300
<i>Maryland Humanities Council</i>	175
<i>Arts Everyday</i>	38
<i>901 Arts</i>	38
<i>Maryland Center for Construction Education and Innovation</i>	250
<i>Baltimore City Health Department:</i> To fund the operation of Baltimore City Safe Streets Program.	1,000
Total	\$79,959

Rainy Day Fund: Revenue Stabilization Account

Source: Fiscal 2017 Budget Bill

Appendix 4
Revenue Stabilization Account (Rainy Day Fund)
Section 7-311 State Finance and Procurement Article

Account Characteristics

- **Purpose:** The account was established in 1986 to retain State revenues to meet future short-term funding needs and to reduce the need for future tax increases by moderating revenue growth.
- **Appropriations:** The account consists of direct appropriations in the budget bill and interest earned from all reserve fund accounts.
- **Required Appropriations If Account Balance Is Less Than 7.5% of General Fund Revenues:** Current law requires that if the fund balance is between 3% and 7.5% of projected general fund revenues, annual appropriations of at least \$50 million must be made until the account balance reaches 7.5% of estimated general fund revenues. If the account balance is below 3%, State law requires an appropriation of at least \$100 million.
- **Sweeper Provision:** State law requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of \$10 million into the Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. For example, fiscal 2008 closed with an unassigned surplus totaling \$185.7 million, thus the Administration’s fiscal 2010 allowance included a \$175.7 million appropriation to the Rainy Day Fund. This appropriation to the Rainy Day Fund is referred to as the “sweeper.” Chapter 489 of 2015 modified the sweeper so that:
 - for fiscal 2017 to 2019, for surpluses above \$10 million, an amount equal to up to \$100 million is split between the Rainy Day Fund and the Pension System. Amounts above \$110 million go to the Rainy Day Fund;
 - for fiscal 2020, for surpluses above \$10 million, an amount equal to up to \$50 million each year goes to the Rainy Day Fund and the Pension System on a dollar-for-dollar basis and amounts above \$110 million go to the Rainy Day Fund; and
 - per Chapter 557 of 2017, for fiscal 2021 and beyond, for surpluses above \$10 million, the first \$100 million is divided between the Rainy Day Fund, Pension System, and Postretirement Health Benefits Trust Fund so that the Rainy Day Fund receives 50%, the Pension System receives 25%, and the Postretirement Health Benefits Trust Fund receives 25% on a dollar-for-dollar basis. Amounts above \$110 million are credited to the Rainy Day Fund.

Mechanisms for Transferring and Spending Funds

The Governor can transfer balance from the Rainy Day Fund above 5% of estimated general fund revenues in the budget bill. To transfer an amount that would reduce the Rainy Day Fund balance below 5% requires the transfer to be authorized in an Act of the General Assembly other than the budget bill.

Rainy Day Fund Activity

The following table illustrates fiscal 2015 through 2019 activity in the Rainy Day Fund. An appropriation totaling \$19.7 million was made in fiscal 2015 to keep a minimum 5% fund balance. In fiscal 2015, the Board of Public Works withdrew \$4.9 million of the appropriation to the fund. This amount was withdrawn because the Administration anticipated that this was the amount above the 5% fund balance target. The fiscal 2017 allowance included the required sweeper appropriation, which totaled \$235.3 million. The budget was amended so that \$80 million was restricted for other uses (see Appendix 3 for details.) The Governor’s plan for fiscal 2017 included a proposed transfer of \$170 million to the General Fund. The fiscal 2019 allowance includes the required \$196.3 million sweeper appropriation to the Rainy Day Fund, along with a \$193 million contingent reduction in the Budget Reconciliation and Financing Act of 2018. The fund is expected to end fiscal 2019 with a fund balance that is equal to 5% of general fund revenues.

Revenue Stabilization Account Status Fiscal 2015-2019 Est.

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018 Est.</u>	<u>2019 Est.</u>
Beginning Balance	\$763.6	\$773.5	\$832.4	\$832.5	\$858.5
Appropriation	19.7	50.0	235.3	10.0	3.3 ¹
Transfer to General Fund	0.0	0.0	-170.0	0.0	0.0
BPW Reduction	-4.9	0.0	0.0	0.0	0.0
Transfer to BPW Contingent Fund	-13.1	0.0	0.0	0.0	0.0
General Fund Reversions	0.0	0.0	-80.0	0.0	0.0
Interest Earnings	8.1	8.9	14.7	16.0	20.7
Ending Balance	\$773.5	\$832.4	\$832.5	\$858.5	\$882.5

BPW: Board of Public Works

¹ Net of contingent reduction in the Budget Reconciliation and Financing Act of 2018.

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

Source: Department of Budget and Management, January 2018

Governor’s Out-year Forecast

The out-year Rainy Day Fund forecast anticipates transfers into the fund, since the fund balance is less than 7.5% of general fund revenues. The Department of Budget and Management’s forecast projects that balances are kept at 5% of general fund revenues, leaving a balance totaling \$1,009.5 million at the end of fiscal 2023. If the funds are kept in the Rainy Day Fund, fiscal 2023 should end with a \$1,062.3 million fund balance, which is 5.8% of general fund revenues.

Appendix 5
Dedicated Purpose Account
Section 7-310 State Finance and Procurement Article

Account Characteristics

- **Purpose:** The account was established in 1986 to retain appropriations for major, multi-year expenditures where the magnitude and timing of cash needs are uncertain and to meet expenditure requirements that may be affected by changes in federal law or fiscal policies or other contingencies.
- **Appropriations:** The account consists of direct appropriations in the budget bill committed to a specific purpose. Interest earnings generated by the account are credited to the Revenue Stabilization Account (Rainy Day Fund).
- **Other:** The unspent balance of an appropriation reverts to the Rainy Day Fund four years after the end of the fiscal year for which the appropriation was made.

Mechanisms for Transferring and Spending Funds

To transfer funds from the Dedicated Purpose Account (DPA):

- funds may be reflected in the State budget subject to appropriation;
- after submission to the budget committees and review and approval by the Legislative Policy Committee (LPC) funds may be transferred by budget amendment to the appropriate Executive Branch agency; or
- the Governor may declare appropriations to the DPA surplus and may transfer funds by budget amendment to the Rainy Day Fund following review by the budget committees and LPC.

Dedicated Purpose Account Activity

The following table illustrates the activity in the DPA from fiscal 2015 through 2019. The account ends the period with no fund balance. In fiscal 2016, \$152.5 million was appropriated. This includes \$140 million to fund legislative priorities, \$10 million to reduce an unfunded liability in the Local Income Tax Reserve Account, and \$2.5 million for information technology (IT) upgrades. In fiscal 2016, \$118.6 million was spent for legislative priorities and the remaining \$21.4 million reverted to the General Fund. IT upgrades were made in fiscal 2016 and 2017. As submitted, the fiscal 2019 Governor’s allowance includes \$71 million in statutorily required appropriations: \$50 million to reduce

Y01A – State Reserve Fund

the pension liability; and \$21 million in Program Open Space (POS) repayments. Contingent reductions propose to eliminate the pension payment and reduce the POS repayment to \$6 million.

Dedicated Purpose Account Status
Fiscal 2015-2019
(\$ in Millions)

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Beginning Balance	\$0.0	\$0.0	\$1.8	\$0.0	\$0.0
Appropriation	\$0.0	\$152.5	\$0.0	\$0.0	\$6.0
Local Income Tax Reserve Repayment		10.0			
Pension Sweeper					50.0
Section 48 to Restore Funding		140.0			
POS Repayment for General Fund Transfers		0.0			21.0
Contingent Reduction					-65.0
Information Technology Upgrades		2.5			
Transfers	\$0.0	-\$150.7	-\$1.8	\$0.0	-\$6.0
Local Reserve Account Repayment		-10.0			
POS Repayment for General Fund Transfers					-6.0
Information Technology Upgrades		-0.7	-1.8		
Section 48 Initiatives Funded by Administration		-49.9			
Section 48 Salary Restoration		-68.7			
General Fund Reversion		-21.4			
Ending Balance	\$0.0	\$1.8	\$0.0	\$0.0	\$0.0

Source: Department of Budget and Management, January 2018

Governor’s Out-year Forecast

The Administration does not have any plans to appropriate any funds into the DPA through fiscal 2023.

Appendix 6
Catastrophic Event Account
Section 7-324 State Finance and Procurement Article

Account Characteristics

- **Purpose:** The account was established in 1990 to enable the State to respond quickly to a natural disaster or catastrophe that could not be addressed within existing State appropriations.
- **Appropriations:** The account consists of direct appropriations in the budget bill. Interest earnings generated by the account are credited to the Revenue Stabilization Account.

Mechanisms for Transferring and Spending Funds

Prior to transferring funds by budget amendment to the appropriate Executive Branch agency, the Administration must notify the Legislative Policy Committee of the proposed amendment and allow the committee to review and approve the proposed amendment.

Catastrophic Event Purpose Account Activity

The following table shows that the account's balance was \$172,937 at the start of fiscal 2015. In fiscal 2016, the Administration's budget included a \$10,000,000 deficiency appropriation. In response to snowstorms, \$567,687 was transferred to the Military Department in fiscal 2016. The Department of Housing and Community Development's Neighborhood Business Development program received \$2,500,000 to support Ellicott City's flood cleanup in fiscal 2017. As of January 2018, \$222,284 of the flood cleanup has been repaid in fiscal 2017 and 2018, with additional repayments anticipated. The Administration has processed a budget amendment to provide \$2,500,000 for Baltimore City schools' heating, ventilation, and air conditioning repairs in fiscal 2018.

Y01A – State Reserve Fund

Catastrophic Event Account
Fiscal 2015-2019
(\$ in Thousands)

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Beginning Balance	\$173	\$173	\$9,605	\$7,231	\$4,828
Appropriation	0	10,000	0	0	0
Snowstorms	0	-568	0	0	0
Ellicott City Flood Relief through BusinessWorks	0	0	-2,500	-2,500	0
BusinessWorks Loan Repayment	0	0	126	96	0
Hurricane Sandy and Derecho Storm Relief	0	0	0	0	0
Ending Balance	\$173	\$9,605	\$7,231	\$4,828	\$4,828

Source: Department of Budget and Management, January 2018