Effect of Long-term Debt on the Financial Condition of the State

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2005

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December 2005

The Honorable Edward J. Kasemeyer, Senate Chairman
Spending Affordability Committee

The Honorable Michael R. Gordon, House Chairman
Spending Affordability Committee

Dear Chairman Kasemeyer and Chairman Gordon:

The Department of Legislative Services' annual report on the *Effect of Long-term Debt on the Financial Condition of the State* is presented. This report essentially follows the format of previous reports and includes a review of the recommendations of the Capital Debt Affordability Committee, an independent affordability analysis, and independent policy recommendations to the Spending Affordability Committee.

The Capital Debt Affordability Committee complements the efforts of the Spending Affordability Committee in management of the State's bonded indebtedness. The Capital Debt Affordability Committee, created by an Act of the 1978 General Assembly, is required to submit a recommended level of debt authorization to the Governor and the General Assembly by September 10 of each year. The existence of the committee within the Executive Branch means that consideration of debt affordability will occur at the time of formulation of the State's capital program, as well as the time of approval of the program by the legislature.

The statistical analysis and data used in developing the recommendations were prepared by Patrick Frank with assistance by Rachel Hise, Monica Kearns, Matthew Klein, Amanda Mock, Greg Potts, and Theresa Tuszynski.

Respectfully submitted,

Warren G. Deschenaux
Director

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Chapter 1. Recommendations of the Department of Legislative Services

New General Obligation Bond Authorization

The Capital Debt Affordability Committee (CDAC) recommended a limit of $690 million for new authorizations of general obligation (GO) bonds during the 2006 legislative session. The recommendation, which is $20 million more than was authorized in the 2005 legislative session, reflects a change in application of the committee's authorization policy. In 1992, the committee adopted a policy to increase authorizations $15 million annually. At the time that this policy was adopted, the $15 million allowed for a 2 percent growth attributable to inflation and 1 percent growth in the program size. Since 1992, annual increases have generally been $15 million. The committee is no longer recommending a $15 million annual escalation; instead it will now recommend 3 percent annual increases, which provides an additional $20 million in fiscal 2007. The recommendation includes $5 million previously authorized for tobacco buyout financing.

In accordance with Section 8-113 of the State Finance and Procurement Article, the Governor notified the General Assembly on the level of State debt that is advisable. The Governor accepted the recommendation of CDAC and provided the following preliminary allocation of the $690 million debt authorization as shown in **Exhibit 1.1**.

Exhibit 1.1
Governor's Proposed GO Bond Capital Program

	GO Debt
State-owned Facilities	$343,400,000
Grant and Loan Programs	196,600,000
Public School Construction	150,000,000
Total	**$690,000,000**

Source: Department of Budget and Management, October 19, 2005

The Department of Legislative Services' (DLS) forecast of personal income and levels of outstanding debt indicates that Maryland's five-year GO debt authorization plan will be affordable according to the debt affordability criteria and that additional capacity remains. However, the forecast also reveals a significant increase in the amount of annual debt service. That growth in the debt service obligation will necessitate an increase in the amount of general funds or property tax revenues allocated towards debt service. **DLS agrees that the committee's debt limit for the 2005 session of $690 million in new GO authorizations meets the affordability criteria and preserves capacity for the future.**

Issuance of Taxable Debt

As a by-product of the most recent fiscal downturn, the State reduced operating budget support for the capital program and has issued taxable debt. Taxable debt has resulted in higher borrowing costs. The State's 2005 issuances of $45 million in taxable debt cost $1.6 million more than issuing tax-exempt debt over the life of the bonds. **To reduce borrowing costs and provide for a more efficient capital program, it is recommended that the Administration appropriate general funds for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds.**

Current Spending Affordability Committee (SAC) policy is to include revolving loan fund capital programs receiving general funds in the SAC spending limit. The committee is concerned that this could create a disincentive to move funding for these capital programs back into the general fund. **To eliminate a potential disincentive to restore general fund appropriations for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds, it is recommended that SAC exclude PAYGO capital general fund appropriations made in the 2006 legislative session from the affordability calculation. This exclusion should be limited to projects previously funded with taxable GO bonds that are funded with general funds instead.**

Authorization of Transportation Debt

The Maryland Department of Transportation competes with other State capital projects within debt affordability limits. Transportation debt capacity is limited by the constraints on debt outstanding, debt service coverage, the cash flow needs for projects in the capital program, and overall State debt affordability limits. **It is recommended that the General Assembly continue to set an annual limit on the level of State transportation debt to keep debt outstanding within the 3.2 percent of personal income debt affordability criterion, and debt service within the 8.0 percent of revenues debt affordability criterion.**

Higher Education Debt

For fiscal 2007, the University System of Maryland (USM) intends to issue up to $50 million in auxiliary debt and $25 million in academic debt. This level of issuance will result in a debt service ratio below the 5.5 percent of current unrestricted funds and mandatory transfers recommended by the system's financial advisers. This level of issuance also allows total available funds to exceed 50 percent of debt outstanding. Morgan State University advises that it plans to issue $18 million debt, but the amounts to be issued have not been determined. This could require legislation increasing the university's debt limit. St. Mary's College and Baltimore City Community College do not plan on issuing any debt in fiscal 2007. **DLS concurs with the committee's assessment that issuing $25 million in new USM academic revenue bonds is affordable.**

Chapter 2. Recommendations of the Capital Debt Affordability Committee

Chapter 43, Acts of 1978 created the Capital Debt Affordability Committee (CDAC). The committee is required to recommend an estimate of State debt to the General Assembly and the Governor. The committee is chaired by the State Treasurer, and other committee voting members are the Comptroller, Secretaries of the Department of Transportation and the Department of Budget and Management, and an individual appointed by the Governor. Chapter 445, Acts of 2005 added as non-voting members the chair of the Capital Budget Subcommittee of the Senate Budget and Taxation Committee and the chair of the Capital Budget Subcommittee of the House Committee on Appropriations. The committee meets each summer to evaluate State debt levels and recommend prudent debt limits to the Governor and General Assembly. The Governor and General Assembly are not bound by the committee's recommendations.

When reviewing State debt, CDAC considers general obligation (GO) bonds, consolidated transportation bonds, stadium authority bonds, bay restoration bonds, Grant Anticipation Revenue Vehicles (GARVEE) revenue bonds, and capital leases supported by State revenues. Bonds supported by non-state revenues, such as the University System of Maryland's Auxiliary Revenue bonds or the Maryland Transportation Authority's revenue bonds, are not considered to be State source debt and are not included in CDAC's debt affordability calculation.

New General Obligation Debt Authorization

GO bonds are backed by the full faith and credit of the State, and they support the State's capital program. **Exhibit 2.1** shows that the committee recommended a $690 million new GO debt authorization limit for the 2006 session. This figure is $20 million more than the last session's authorization. It includes $5 million for the Southern Maryland Regional Strategy-Action Plan for Agriculture, referred to as the Tobacco Transition Program. The long-range plan adopted by the committee represents a change in its authorization policy. This policy was modified to allow for 3 percent annual increases, and a $100 million reduction in authorizations is no longer planned in 2009. A complete discussion of GO bond authorizations, issuances, and costs is provided in Chapter 3.

Exhibit 2.1
Capital Debt Affordability Committee's
Recommended Levels of General Obligation Bond Authorizations
($ in Millions)

Session	2004 Proposed GO Bond Authorizations	Additional CDAC Proposed Authorizations	Preauthorized Tobacco Transition Program	Total Proposed Authorization
2006	$680	$5	$5	$690
2007	695	10	5	710
2008	710	15	5	730
2009	630	115	0	745
2010	645	125	0	770
Total	**$3,360**	**$270**	**$15**	**$3,645**

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations for Fiscal 2007*, September 2005

Higher Education Academic Debt to Be Authorized

CDAC recommends limiting new debt authorization for academic facilities to $25 million for the next fiscal year, which is equal to the amount authorized in the 2005 legislative session. The entire $25 million is intended for projects on University System of Maryland campuses. CDAC notes that the proposed capital financing programs for the public higher education systems result in a debt burden level, measured as debt service as a percentage of the sum of unrestricted current fund expenditures plus mandatory transfers, is well below the 10 percent "highly leveraged" threshold established by Standard & Poor's. Academic bond issuances are discussed in Chapter 6.

Chapter 3. State Debt

Maryland's statutes allow for the issuance of the following types of State debt:

- general obligation (GO) bonds backed by the full faith and credit of the State;
- Qualified Zone Academy Bonds (QZABs) backed by the full faith and credit of the State;
- capital leases, annual payments of which are subject to appropriation by the General Assembly;
- revenue bonds and notes issued by the Maryland Department of Transportation (MDOT), backed by operating revenues and pledged taxes of the department;
- Grant Anticipation Revenue Vehicles (GARVEEs) pledging projected future federal transportation grants to support debt service payments. GARVEEs can be issued by MDOT and the Maryland Transportation Authority (MdTA);
- revenue bonds issued by the Maryland Stadium Authority (MSA), secured by a lease which is supported by State revenues;
- bay restoration bonds issued by the Maryland Department of the Environment's (MDE) Water Quality Financing Administration (WQFA), pledging revenues from the Bay Restoration Fund; and
- revenue or bond anticipation notes which may be issued by the Treasurer and which must be repaid within 180 days of issuance. Currently, there are no anticipation notes outstanding.

General Obligation Bonds

GO bonds are authorized and issued to pay for the construction, renovation, or equipping of facilities for State, local government, and private sector entities. Grants and loans are made to local governments and private sector entities when a State's needs or interests have been identified. Projects funded with GO bonds include public and private colleges and universities, public schools and community colleges, prisons and detention centers, hospitals, and low-income housing projects. **Appendix 1** shows the projects that are requested.

The State issues two kinds of GO bonds, taxable and tax-exempt. This chapter discusses the effect of tax-exempt debt. The report raises specific issues about tax-exempt debt, which is discussed in Chapter 7.

New General Obligation Bond Authorizations

The Capital Debt Affordability Committee (CDAC) recommended a limit of $690 million for new authorizations of GO bonds during the 2006 session. The recommendation includes a planned $5 million for tobacco buyout financing, as required by Chapter 103, Acts of 2002.

The recommendation, which is $20 million more than was authorized in the 2005 session, reflects a change in application of the committee's authorization policy. In 1992 the committee adopted a policy to increase authorizations $15 million annually. At the time that this policy was adopted, the $15 million allowed for a 2 percent growth attributable to inflation and 1 percent growth in the program size. In 1992, 3 percent growth provided for a $15 million annual increase. In subsequent years, the committee followed a policy of increasing authorizations $15 million annually, with exceptions made if additional authorizations were affordable and justifiable.

As the capital program has grown, the $15 million increase resulted in an even smaller percentage growth rate. To allow the program to grow 3 percent annually, the committee has now adopted the practice of increasing authorizations 3 percent, instead of a fixed amount (e.g., $15 million annually). While this is not exactly a new policy (since the policy had been to increase authorizations 3 percent annually since 1992), this does reflect a change in practice that is expected to result in additional authorizations, issuances, and debt service costs. Through the 2008 session, this adds $20 million in authorizations annually. Beginning in 2009, the growth is $25 million annually.

Another adjustment to out-year authorizations is to eliminate the dip in the program that was previously recommended for the 2009 session. In its 2003 report, the committee recommended that authorizations be increased $100 million in each session from 2004 to 2008, to realize an additional $500 million in authorizations. At the time, the justification for the additional authorizations was to keep a more stable capital program. The concern was that surplus general funds that had previously supported the PAYGO capital program were no longer available, resulting in a decline in funds to maintain the capital program. At the time, it was also agreed that the authorizations be reduced again in 2009 to previously proposed levels.

Exhibit 3.1 shows that the 2005 report now recommends a total of over $3.6 billion in authorizations from 2006 to 2011. This is an increase of $270 million over the five-year period. The CDAC report does not link the increase in funding to additional public school construction. However, the funding does provide additional authorizations for spending currently not in the *Capital Improvement Program*, and these authorizations could be used to support the public school construction program. (Chapter 7 includes a discussion of the public school construction program.)

Exhibit 3.1
Effect of New Policy on GO Bond Authorizations
2006 − 2010 Legislative Sessions
($ in Millions)

Session	2004 Report Recommended Authorizations	2005 Report Recommended Authorizations	Increased Authorization
2006	$685	$690	$5
2007	700	710	10
2008	715	730	15
2009	630	745	115
2010	645	770	125
Total	**$3,375**	**$3,645**	**$270**

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, September 2004 and 2005

General Obligation Bond Issuance Stream

GO bonds authorized in a given year are not issued in total the following year. In fact, the Treasurer reports that just over half of the GO bonds authorized in a year are typically issued within the next two fiscal years. Specifically, CDAC assumes bonds authorized in a given year will be fully issued over five years (31 percent in the first year, 25 percent in the second year, 20 percent in the third year, 15 percent in the fourth year, and 9 percent in the fifth year). This delay in issuance results in a substantial lag between the time general obligation debt is authorized and when it has a significant impact on debt outstanding and debt service levels.

The bond issuance stream influences debt outstanding and debt service calculations on which the affordability calculations are based. **Appendix 2** shows how the proposed authorizations for fiscal 2005 through 2015 would be issued. **Exhibit 3.2** compares this year's issuance stream to last year's to reveal higher issuance levels through fiscal 2015. The increased issuance is largely attributable to the increased authorizations recommended by CDAC in this year's report.

Exhibit 3.2
Proposed Issuance Stream
Fiscal 2006 − 2015
($ in Millions)

Fiscal Year	Last Year's Report	Current Year's Report
2006	$650	$750
2007	650	675
2008	675	700
2009	700	725
2010	700	725
2011	725	750
2012	725	775
2013	725	800
2014	750	825
2015	750	835
Total	**$7,050**	**$7,560**

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations,* September 2004 and 2005

The table in Appendix 2 also indicates the expected issuances of current authorizations. At the beginning of fiscal 2005, over $1.8 billion in debt was authorized by the General Assembly but not issued. The CDAC report assumes that $461 million of this debt will be issued in fiscal 2006.

General Obligation Bond Debt Service Costs

The committee's recommendation to increase authorizations is projected to increase debt service costs in the out-years. The increase is expected to be somewhat modest in the early years. This is attributable to the issuance stream and the State's policy of paying only interest in the first two years after issuing GO debt. As previously mentioned, because most authorized projects are not fully funded in the first year, it is assumed that bonds are issued over five years. If the additional debt service supports projects with shorter planning periods, debt will be issued sooner and increased debt service payments will be more substantial in the early years. Conversely, if the new projects take longer to plan, initial debt service payments could be lower.

Exhibit 3.3 shows that debt service costs are $13 million more than projected in fiscal 2006. By fiscal 2015, debt service costs are $46 million more than previously estimated. Increased debt service projections are attributable to larger than expected issuances in 2005 and to expanding the GO bond program's authorizations. These debt service costs were partially offset by issuing $281 million in refunding bonds which reduced debt service by $11.6 million (as discussed in the next section).

Exhibit 3.3
Projected Debt Service Costs
Fiscal 2006 − 2015
($ in Millions)

Fiscal Year	2004 Report Estimated Debt Service Costs	2005 Report Estimated Debt Service Costs	Increased Debt Service Costs
2006	$613	$625	$13
2007	638	657	19
2008	671	697	26
2009	721	747	26
2010	755	779	24
2011	793	823	30
2012	821	855	35
2013	854	892	37
2014	881	918	38
2015	911	957	46

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, September 2004 and 2005

In the short term, some of this growth in debt service is due to larger than expected bond sales in 2005. CDAC assumed that $575 million in new GO bonds would be issued in 2005, while actual issuances totaled $825 million. Since this is previously authorized debt that would have been issued anyway, this does not alter the long-term debt service costs, but it does affect short-term debt service payments.

Long-term debt service expenditure growth is also a function of increased authorizations. As previously mentioned, additional authorizations increase GO bond issuances. Ultimately, this drives up debt service costs. Most of the additional debt service is attributable to the additional authorizations.

Some of the growth is attributable to higher interest rates, which are projected to rise to 5.5 percent by spring 2007. Insofar as current debt offers a 5.0 percent interest rate, increasing interest rates are expected to have a limited effect on debt service costs. The most substantial effect of higher interest rates is to eliminate the bond sale premiums that the State has been receiving in recent years. Chapter 7 discusses long-term debt costs and its relationship with State revenues.

General Obligation Bond Refunding

In recent years, low interest rates provided the State with the opportunity to refund bonds. The bonds were financed by issuing new debt, at lower interest rates. The new debt was placed in an escrow account, from which debt service payments for the previously issued debt are made. This increases gross GO bond debt outstanding, but net debt remains constant. The following issuances refunded bonds:

- The March 2002 bond sale included $109.9 million in principal with $117.2 million placed into escrow (includes a $7.5 million premium) to refund the prior bonds. Over the term of the bonds, this results in debt service savings of $10.8 million.

- The July 2002 bond sale included $290.8 million in principal with $315.3 million placed into escrow (includes $24.7 million premium) to refund the prior bonds. The gross savings on this refunding is $17.5 million.

- The February 2003 bond sale issued $86.1 million in principal and placed $95.8 million (includes $9.6 million premium) in escrow to refund previously issued bonds. The debt service savings on this refunding are $6.4 million.

- The October 2004 bond sale issued $574.7 million in principal and placed $631.1 million into escrow to refund previously issued bonds. The debt service savings are $23.1 million.

- The March 2005 bond sale issued $281.2 million in bonds and placed $292.3 million into escrow to refund previously issued bonds. The debt service savings are $11.6 million.

Exhibit 3.4 shows that annual savings from these five recent bond sale refunding issuances reduced GO bond debt service costs by a total of $69 million. The State Treasurer's Office, with advice from its financial advisor, determines whether refinancing general obligation debt is advantageous. Should interest rates fall to a point where it is determined that there would be sufficient savings to warrant a refunding, such action would be presented to the Board of Public Works (BPW) for its approval.

Exhibit 3.4
Savings as Attributable to Refunding Bonds
Fiscal 2002 − 2016
($ in Thousands)

Fiscal Year	Mar-02	Jul-02	Feb-03	Oct-04	Mar-05	Total
2002	$2,292	$0	$0	$0	$0	$2,292
2003	2,244	9,150	428	0	0	11,822
2004	2,360	1,320	660	0	0	4,341
2005	692	5,251	50	8,451	0	14,445
2006	1,620	1,359	958	1,546	1,927	7,410
2007	1,477	213	1,329	5,055	281	8,355
2008	80	187	1,472	5,331	281	7,351
2009	80	10	1,475	785	281	2,631
2010	0	4	0	796	4,776	5,576
2011	0	0	0	796	1,572	2,369
2012	0	0	0	182	21	203
2013	0	0	0	152	1,211	1,363
2014	0	0	0	14	1,192	1,206
2015	0	0	0	12	65	77
2016	0	0	0	14	0	14
Total	**$10,846**	**$17,495**	**$6,373**	**$23,134**	**$11,607**	**$69,455**

Source: State Treasurer's Office, Public Resources Advisory Group

Qualified Zone Academy Bonds

QZABs were created under the federal Tax Reform Act of 1997 as a new type of debt instrument to finance specific education projects. In Maryland, the proceeds support the Aging School Program. QZABs are issued with the full faith and credit of the State. Consequently, QZABs are considered State debt. For purposes of calculating State debt affordability, QZABs are included in the State's GO bond debt outstanding and debt service.

The State does not pay interest on QZABs. Instead, bondholders receive a federal income tax credit for each year the bond is held. The State is not required to make payments on the principal until the bonds are redeemed. For example, under its 2001 agreement with Bank of America, the State, through the Treasurer's Office, makes annual payments into a sinking fund invested into a guaranteed rate of interest. Since the funds are invested in interest bearing accounts, the repayment of the principal by the State comes out to be less than the par value of QZABs.

To date, the State has authorized two QZAB issuances. The first issuance, which includes two authorizations, was bid in September 2001. The total amount bid was $18.1 million. Sinking fund payments total $11.5 million. The second issuance was bid in November 2004. Sinking fund payments total $6.9 million. Chapter 431, Acts of 2005 authorizes another $9.4 million in QZABs. These QZABs have not been issued. The Interagency Committee on School Construction, which administers the Aging School Program, advises that the federal government requires that a portion of this authorization must be issued by December 31, 2006. The affordability analysis assumes that the bonds will be bid in spring 2006.

Exhibit 3.5 demonstrates the cost savings of issuing QZABs as opposed to GO bonds under the most recent QZAB issuance totaling $9 million. Under an issuance of GO bonds, the State's total obligation is $12.5 million as compared to $6.9 million under the QZAB issuance for a savings of $4.6 million. When issuing GO bonds the State has to pay both interest and principal to the bondholder. In the case of QZABs, the State's only liability is on the principal of the bond, which generates interest revenues while in escrow.

Exhibit 3.5

GO Bond and QZAB Debt Service Cost Comparison

Series 2004 – $9,043,000 Issuance

($ in Thousands)

Fiscal Year	GO Debt Service	QZAB Sinking Fund	QZAB Savings
2004	-$1,001 [1]	$0	-$1,001
2005	452	490	-38
2006	452	490	-38
2007	962	490	472
2008	962	490	471
2009	965	490	475
2010	962	490	471
2011	962	490	472
2012	961	490	471
2013	964	490	473
2014	964	490	474
2015	963	490	473
2016	961	490	470
2017	961	490	471
2018	965	490	474
2019	964	490	474
Total	**$12,456**	**$6,865**	**$4,590**

Note: Insofar as State GO bond sales generate a premium, selling additional GO bonds will produce a similar premium and this premium is reflected in this analysis.

[1] Insofar as current bond sales are generating a premium, the analysis assumes that issuing GO bonds, instead of QZABs would generate a premium. This $1 million reflects the estimated bond sale premium.

Source: State Treasurer's Office; Department of Legislative Services

Capital Leases Supported by State Revenues

Beginning in 1987, the State's capital program began utilizing lease/leaseback financing for capital projects. These leases are used to acquire both real property and equipment. Beginning in fiscal 1994, the State instituted a program involving equipment leases for energy conservation projects at State facilities to improve energy performance.

For real property, the transaction generally involves an agreement in which the State leases property to a developer who in turn builds or renovates a facility and leases it back to the State. At the end of the lease period, ownership of the facility is transferred to the State. Equipment leases are generally for shorter periods of time, from three to five years.

For energy performance projects, agencies make lease payments using the savings that result from implementation of the conservation projects. Section 8-401 to 8-407 of the State Finance and Procurement Article regulates leases. The law requires that capital leases be approved by BPW and that the Legislative Policy Committee (LPC) has 45 days to review and comment on any capital lease prior to submission to BPW.

All three types of leases (equipment, energy-performance, and property) have advantages. Often, equipment leases involve high technology equipment, such as data processing equipment or telecommunications equipment. Equipment leases offer the State more flexibility than purchases since leases can be for less than the entire economic life of the equipment. Equipment leases are especially attractive in an environment where technology is changing very rapidly. Leases can also be written with a cancellation clause that would allow the State to cancel the lease if the equipment were no longer needed. Currently, the Treasurer's lease-purchase program consolidates the State's equipment leases to lower the cost by reducing the interest rate on the lease. The rate the Treasurer receives for the State's equipment leases financed on a consolidated basis is less than the rates individual agencies would receive if they financed the equipment leases themselves.

The primary advantages of property leases when compared to general obligation bonds are that they allow the State to act more quickly if an unanticipated opportunity presents itself. Because of the extensive planning and legislative approval process involved in the State's construction program, it often takes years to finance a project. Lease agreements are approved by BPW after they have been reviewed by the budget committees. Since BPW and the budget committees meet throughout the year, leases can be approved much more quickly than general obligation bonds, which must be approved by the entire General Assembly during a legislative session. Therefore, property leases give the State the flexibility to take advantage of economical projects, which are unplanned and unexpected.

Using the savings realized in utility cost reductions to pay off energy-performance project leases allows projects to proceed that otherwise might not be of high enough priority to be funded given all of the other competing capital needs statewide. Under the program, utility costs will decrease; and as the leases are paid off, the savings from these projects will accrue to the State.

The CDAC's out-year forecast shows current leases and projected activities for equipment and energy-performance leases. The forecast does not assume any new real property leases in the out-years. The nature of real property leases makes it difficult to project out-year costs since they tend to be one-time opportunities that have a short lead time. For example, there is a wide range of costs as some leases' total value is less than $10 million while others is greater than $40 million.

Exhibit 3.6 shows tax-supported capital lease debt outstanding totals $175.1 million as of June 30, 2005. Since the end of fiscal 2005, the State has entered into a lease for a 750-space parking garage on Calvert Street in Annapolis. MdTA sold bonds and will construct the new facility, while the Department of General Services will lease and maintain the facility. The construction bonds did not go into settlement until fiscal 2006 (July 2005), so the project is not listed in Exhibit 3.6.

Exhibit 3.6
Tax-supported Capital Lease Debt Outstanding
As of June 30, 2005
($ in Thousands)

Maryland Economic Development Corp. – MDOT Headquarters	$33,275
St. Mary's Multi-Service Center	4,725
Towson District Court	3,275
Hyattsville Multi-Service Center	4,445
Hilton Street Facility	1,265
Calvert County Multi-Purpose Center	2,840
Prince George's County Justice Center	2,857
Baltimore City Community College Modular Surge Space Building	197
Eastern Correctional Institution Water and Wastewater Facilities	3,840
Energy Performance Leases	35,105
Equipment Leases	83,239
Total	**$175,062**

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

Source: Treasurer's Office; Department of Budget and Management; and Maryland Department of Transportation

Transportation Debt

MDOT issues 15-year, tax-supported consolidated transportation bonds. Bond proceeds are usually earmarked for highway construction. Revenues from taxes and fees and other funding sources accrue to the Transportation Trust Fund (TTF) to pay debt service, pay operating budget requirements, and to support the capital program. Debt service on consolidated transportation bonds is payable solely from the TTF.

In addition to issuing consolidated transportation bonds, MDOT also issues debt known as nontraditional debt. The term nontraditional debt refers to a variety of debt instruments that are utilized by MDOT but that are not consolidated transportation bonds. Nontraditional debt currently includes Certificates of Participation, Maryland Economic Development Corporation (MEDCO) debt, and debt sold on MDOT's behalf by MdTA. As of June 30, 2005, MDOT had $766.7 million in nontraditional debt outstanding. Of the eight outstanding issuances of nontraditional debt, four are tax-supported and fall under the purview of CDAC.

Statute does not impose any limit on the total amount of nontraditional debt that MDOT may issue. However, the General Assembly adopted budget language in the fiscal 2006 budget that imposes a ceiling of $754.1 million on the total amount of nontraditional debt that may be outstanding as of June 30, 2006. MDOT may increase the aggregate outstanding unpaid and principal balance of nontraditional debt above this ceiling during the fiscal year if it notifies the budget committees explaining the reason the additional issuance is needed. MDOT expects that $749.4 million in nontraditional debt will be outstanding as of June 30, 2006.

Consolidated Transportation Bonds

The issuance of transportation debt is limited by two criteria: an outstanding debt limit and a coverage test. Section 3-202(b) of the Transportation Article establishes the maximum aggregate and unpaid principal balance of consolidated transportation bonds that may be outstanding at any one time. During the 2004 session, the maximum outstanding debt limit was increased to $2 billion (from $1.5 billion) due to the adoption of provisions that increased vehicle registration fees.

Section 3-202(c) of the Transportation Article further requires the General Assembly to establish each year in the State budget the maximum unpaid principal balance in bonds that may be outstanding at the end of the forthcoming year. The fiscal 2006 budget bill set the maximum ceiling for June 30, 2006, at $1,333,475,000, with an allowance to increase the debt outstanding by another $15 million provided such an increase is justified to the budget committees prior to the publication of a preliminary official statement. The Department of Legislative Services (DLS) estimates that as of June 30, 2006, MDOT will have $1,218,475,000 in debt outstanding.

The bond revenue coverage test, which is established in MDOT's bond resolutions, mandates that net revenues and pledged taxes must each equal at least twice (2.0) the maximum future debt service. MDOT has adopted an administrative policy establishing a minimum coverage of 2.5. Based on projected bond sales, DLS estimates that as of June 30, 2006, MDOT will have net income coverage of 5.8 and pledged taxes coverage of 8.4.

As shown in **Exhibit 3.7**, MDOT has issued consolidated transportation bonds in 12 of the past 17 years. MDOT last issued new debt in May 2004 (fiscal 2004) when bonds totaling $320 million were sold. MDOT anticipated a bond sale of $35 million in fiscal 2005, but the bond sale was not necessary and not issued.

Exhibit 3.7

Consolidated Transportation Bond Issuance*

($ in Millions)

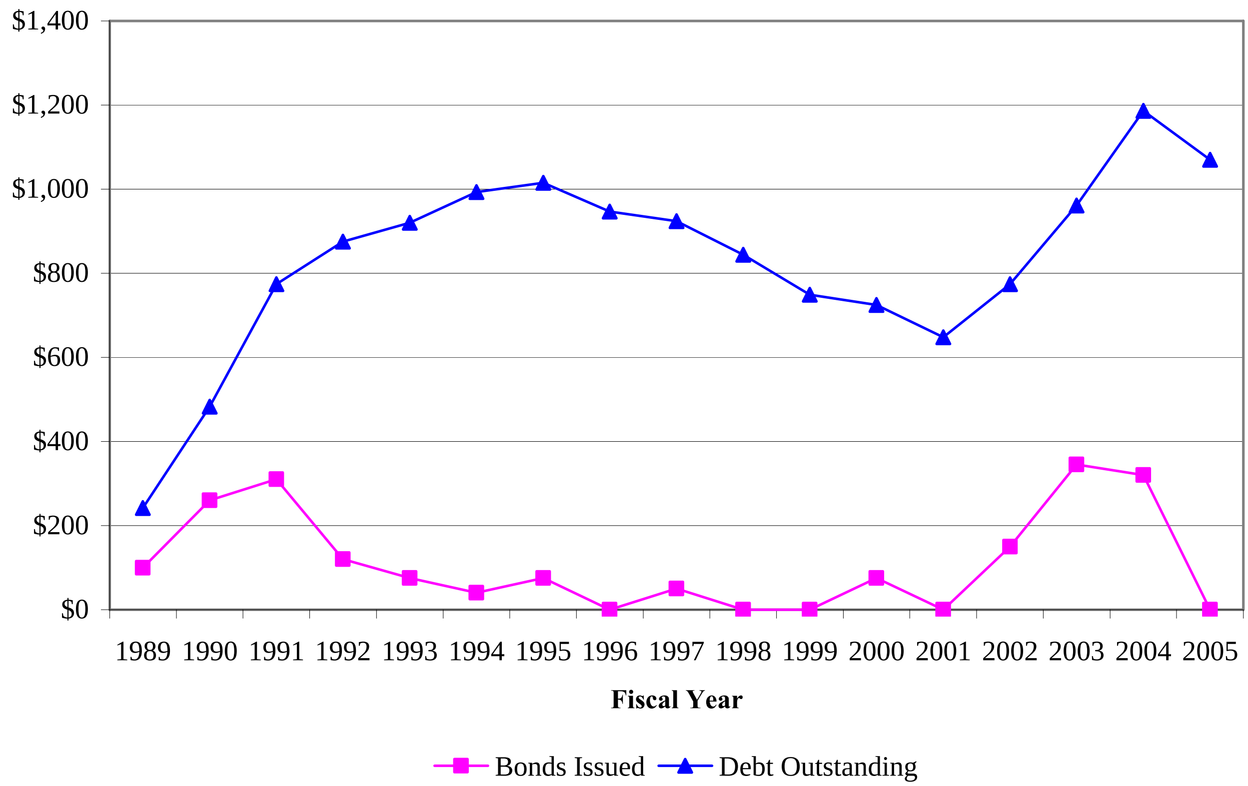
Fiscal Year	Bonds Issued
1989	$100
1990	260
1991	310
1992	120
1993	75
1994	40
1995	75
1996	0
1997	50
1998	0
1999	0
2000	75
2001	0
2002	150
2003	345
2004	320
2005	0
Total	**$1,920**

*Exclusive of refinancing. Four refinancing issuances were made from fiscal 1989 through 2005, including most recently in fiscal 2004, when a total of $75,900,000 was refinanced.

Source: Maryland Department of Transportation

Exhibit 3.8 illustrates annual bond sales and changes in debt outstanding from fiscal 1989 to 2005. In fiscal 2005, MDOT's net debt outstanding was $1.07 billion and no bonds were issued. MDOT is well under the $2 billion debt outstanding debt limit.

Exhibit 3.8
MDOT Bonds Issued and Net Debt Outstanding
Seventeen-year Summary – Fiscal 1989 – 2005
($ in Millions)



Source: Maryland Department of Transportation

Capital Leases

In late June 2002 (fiscal 2002), MDOT entered into a $36 million transaction with MEDCO to obtain proceeds to finance the construction and acquisition of the new MDOT headquarters building. This issuance, which is among the nontraditional debt issuances subject to the overall limit on nontraditional debt, is repaid using funds from the TTF. As of June 30, 2005, there was $33.3 million in debt outstanding for this project.

Future Debt Issuance

In an October 2005 forecast, DLS adjusted MDOT bond sales to increase debt capacity and still stay within the $2 billion debt outstanding limit and the 2.5 net income coverage ratio. **Exhibit 3.9** shows the projected level of debt to be issued for fiscal 2006 through 2011. DLS estimates that MDOT will be able to issue $1.33 billion in debt from fiscal 2006 to 2011. During the same period, the October 2005 MDOT forecast projects $1.15 billion in debt issuances.

Exhibit 3.9
Consolidated Transportation Bonds – DLS Projected Issuances
Fiscal 2006 – 2011
($ in Millions)

Fiscal Year	Amount
2006	$155
2007	215
2008	240
2009	205
2010	270
2011	240
Total	**$1,325**

Source: Department of Legislative Services

Debt Service

Exhibit 3.10 shows DLS estimated debt service based on DLS issuance estimates for the period fiscal 2006 through 2011. DLS projects that debt service will total $942 million from fiscal 2006 to 2011, averaging $157 million per year. During the same period, the October 2005 MDOT forecast projects $899 million in debt service payments.

Exhibit 3.10
DLS Projected Transportation Debt Service
Fiscal 2006 − 2011
($ in Millions)

Fiscal Year	Projected Debt Service
2006	$146
2007	131
2008	141
2009	159
2010	172
2011	193
Total	**$942**

Source: Department of Legislative Services

County Transportation Bonds

Prior to 1993, MDOT issued debt on behalf of the counties and Baltimore City for local projects. These bonds received AA ratings which were generally more favorable than the rates received on most county bond issues. County transportation bonds were considered debt of both the counties and the State.

Chapter 539, Acts of 1993 authorized MDOT to issue bonds for the local jurisdictions that no longer count against State debt affordability limits but instead count only toward the debt outstanding of the counties. MDOT continues to be responsible for all aspects of administering and issuing debt for the counties. The department charges the counties an administrative fee for servicing the bond issues. Debt service on the bonds was and will continue to be paid from the local share of transportation revenues.

In November 1993, MDOT refunded nine series of previously issued county debt. There are two remaining series of county debt issues that were not refunded and, therefore, will continue to count against State debt affordability limits until the issues are retired. As of November 15, 2005, the remaining net principal balance of the bonds totaled $865,000. These issues will be retired November 15, 2006.

Grant Anticipation Revenue Vehicles

GARVEEs are bonds that are issued by states and public authorities that are backed by future federal-aid highway and transit appropriations. While the source of funds used to repay GARVEE issuances originates with the federal government, the federal government's agreement to the use of its funds in this manner does not constitute any obligation on the part of the federal government to make these funds available. If for any reason federal appropriations are not made as anticipated, the obligation to repay GARVEEs falls entirely to the state agency or authority that issued them.

Chapter 472, Acts of 2005 authorizes the use of GARVEE bonds for the InterCounty Connector (ICC) project. The law stipulates that the State may issue no more than $750 million in GARVEE bonds and that bond maturity may not exceed 12 years after date of issue. MdTA plans to issue GARVEE bonds for the ICC. MdTA assumes the issuance of $375 million in fiscal 2006, $325 million in fiscal 2008, and $50 million in fiscal 2010. GARVEE debt service is projected at $43 million in fiscal 2007 and 2008, $80 million in fiscal 2009 and 2010, and $86 million in fiscal 2011.

After some discussion during the 2005 session, it was determined that GARVEE debt will count toward the 3.2 percent of personal income and debt service debt affordability criteria. The first GARVEE issuance of $375 million, planned for fiscal 2006, will count toward this criterion.

Conclusions and Recommendations on Transportation Debt

MDOT competes with other State capital projects within debt affordability limits. Transportation debt capacity is limited by the constraints on debt outstanding, debt service coverage, the cash flow needs for projects in the capital program, and overall State debt affordability limits. **It is recommended that the General Assembly continue to set an annual limit on the level of State transportation debt to keep debt outstanding within the 3.2 percent of personal income debt affordability criterion and debt service within the 8.0 percent of revenues debt affordability criterion.**

Maryland Stadium Authority

MSA was created in 1986 (Chapter 283, Acts of 1986) to construct and operate stadium sites for professional baseball and football in the Baltimore metropolitan area. Legislation authorized MSA to issue tax-exempt revenue bonds for property acquisition and construction costs related to the construction of two stadiums at Baltimore's Camden Yards. The authority may also participate in the development of practice fields, team offices, parking lots, garages, and other related properties. In subsequent years, MSA's role was expanded to include managing and issuing debt in the form of revenue bonds for the renovation and expansion of convention centers in Baltimore and Ocean City, the construction of a conference center in

Montgomery County, the renovation of the Hippodrome Performing Arts Center, and the renovation of Camden Station. **Exhibit 3.11** lists the debt authorized, the amount of debt outstanding, and the amount of annual debt service required for the projects for which MSA has been authorized to issue revenue bonds.

Exhibit 3.11
Maryland Stadium Authority
Revenue Debt Authorizations, Debt Outstanding, and Debt Service
($ in Millions)

Project	Authorized	Outstanding as of October 2005	Debt Service Fiscal 2006
Baseball and Football Stadiums	$235.0	$201.9	$21.6
Baltimore City Convention Center	55.0	34.2	4.9
Ocean City Convention Center	17.3	11.5	1.5
Montgomery County Conference Center	23.2	22.4	1.8
Hippodrome Performing Arts Center	20.3	18.4	1.8
Camden Station	8.7	8.7	0.5
Total	**$359.5**	**$297.1**	**$32.0**

Source: Maryland Stadium Authority

Camden Yards Sports Complex

Provisions of the Financial Institutions Article limit the amount of bonds the authority may issue at the Camden Yards Sports Complex and the allocation of outstanding tax supported debt. The authority may only exceed the limit with approval of BPW and notification to LPC. During the construction of the baseball and football stadiums, the Stadium Authority remained within the statutory limit of $235 million in outstanding debt; however, BPW has on several occasions reallocated the specific statutory project limits to meet the cash-flow needs of the construction efforts. Debt service is supported by lottery revenues. The last such reallocation took place after MSA sold $10.25 million of Sports Facilities Taxable Lease Revenue Refunding Bonds in July 2002. These bonds were sold to refund the principal of bond anticipation notes that were issued to satisfy an arbitration panel's ruling that MSA deposit $10 million in a special fund from which improvements to Orioles Park at Camden Yards are funded.

Baltimore and Ocean City Convention Centers

The authority issued $55 million in revenue bonds for the Baltimore City Convention Center project as authorized by legislation in 1993. Baltimore City issued $50 million in city bonds, and the State contributed another $58 million in general obligation bond funding toward the cost of construction for the project, which was completed in 1997. The fiscal 2006 debt service cost for the authority’s revenue bonds is $4.9 million and subject to State appropriation. The State is also statutorily required to contribute two-thirds toward the convention center’s annual operating deficit through fiscal 2008 and $200,000 annually to a capital improvement fund.

The authority issued $17.3 million in revenue bonds for the Ocean City Convention Center (OCCC) project, authorized in 1995, which was matched by a contribution from the town of Ocean City. The fiscal 2006 debt service cost for the authority’s revenue bonds is $1.5 million and subject to State appropriation. The State is also statutorily required to contribute one-half toward OCCC’s annual operating deficit through fiscal 2008 and $50,000 annually to a capital improvement fund.

Montgomery County Conference Center

On July 7, 2003, the authority issued $23.2 million in tax-supported bonds to support the construction of the Montgomery County Conference Center. Of this amount, $20.3 million constitutes the State’s contribution to the construction costs. The remaining bond proceeds fund a capitalized interest account established as part of the financing plan to fund interest-only debt service payments beginning on June 15, 2003, and continuing through June 15, 2004. Debt service payments thereafter and continuing through June 15, 2024, are paid from funds subject to appropriation by the State. The fiscal 2006 debt service costs for the authority’s revenue bonds are $1.8 million. The project is currently projected to cost $36.5 million excluding the cost of capitalized interest, issuance, and underwriting costs. Montgomery County is contributing $13.7 million for construction and another $2.5 million for project-related enhancements.

Hippodrome Performing Arts Center

On July 10, 2002, the authority issued $20.25 million in taxable revenue bonds for the renovation of the Hippodrome Performing Arts Center. The total cost of the Hippodrome project was $63 million excluding capitalized interest expense. Funding for the project was provided by the State, MSA revenue bonds, Baltimore City, Baltimore County, private contributions, the performing arts center’s operator, historic tax credits, and interest earnings. The project was completed in February 2004.

Debt service payments averaging $1.8 million annually for the 20-year term of the bond are derived from the State’s general fund subject to appropriation. More specifically, the Hippodrome will be leased to the State and subsequently leased back to MSA. The rent paid under the lease by the State is equivalent to the debt service on the revenue bonds and is derived from the State's general fund. The debt service is partially offset by a $2 per ticket surcharge for events at the Hippodrome. The legislation authorizing the project requires the theatre operator to collect a $2 ticket surcharge on each ticket sold for events held at the Hippodrome. These revenues, estimated at $690,000 for calendar 2004 and increasing to approximately $825,000 by fiscal 2008, will fund a portion of the annual debt service requirement.

Camden Station

Section 13-708.1 of the Financial Institutions Article provides that the authority may develop any portion of Camden Yards for the purpose of generating incidental revenues for the benefit of the authority subject to approval of BPW and LPC. The authority received LPC approval in January 2003 and BPW approval in December 2003 to renovate Camden Station.

In February 2004, the authority issued $8.7 million in 20-year taxable revenue bonds for the renovation of the Camden Station. Of that amount, $8.0 million is to pay for capital construction associated with the development of the project. The remaining bond proceeds will be used to pay capitalized interest, costs of issuance, and bond insurance. The capital interest period covers biannual debt service payments though June 15, 2006. The fiscal 2006 debt service costs for the authority's revenue bonds are $504,800 and subject to State appropriation. Phase I of the project, involving the basement and first floor, was completed in March 2005. Phase II, involving the second and third floors, is expected to be completed by August 2006.

The authority's projections through fiscal 2010 show positive cash flow for the project. The Babe Ruth Museum will rent approximately 22,551 square feet located in the basement and on the first floor, and Geppi's Entertainment Museum will rent approximately 17,254 square feet on the second and third floor. The projection assumes a fully leased building and a 3 percent escalation of revenues and expenses annually.

Local Project Assistance

Uncodified language in Chapter 138, Acts of 1998 (1998 capital budget bill) authorizes the authority to assist State agencies and local governments in managing construction projects upon notification of the budget committees and with the provision that funding be provided entirely by the agency or local government requesting assistance unless funding is specifically provided in the budget for the project. The projects for which the authority is currently authorized to provide assistance but is not authorized to issue revenue bonds are:

- Charles County – Minor League Baseball Stadium
- Baltimore City – Feasibility Study for a new arena in downtown Baltimore
- Baltimore City – Coppin State University Physical Education Complex

Horse Park and Motor Sports Park Feasibility Studies in Progress

The authority currently is exploring the feasibility of building a horse park complex that will include facilities for non-racing competition and other equestrian activities. In October 2005, the authority selected the Naval Academy Dairy Farm in Gambrills among six site proposals for the feasibility study. The study involves conceptual design, analysis of infrastructure needs, potential revenue sources, and estimated economic impact.

The horse park feasibility study is expected to be complete in December 2005. If the economic impact and cost studies indicate proceeding with the project, the authority will propose legislation that will provide the necessary financing authorization for consideration by the 2006 General Assembly. The cost of the project is estimated between $75 million and $100 million.

The authority also is conducting a feasibility study on a motor sports park at the Allegany Fairgrounds. The fairgrounds currently have a 1.5 mile dirt track, and the study will explore the feasibility of converting the track to asphalt. The conversion could improve the prospects of the motor sports park, but it still would be too small for NASCAR racing. The motor sports park study is expected to be completed in December 2005.

Insofar as the State has not completed the feasibility studies and very few details are known about the projects, these projects are excluded from the affordability analysis and long-term debt projections.

Bay Restoration Bonds

The Bay Restoration Fund was created in 2004 to provide grants for Enhanced Nutrient Removal (ENR) pollution reduction upgrades at the State's 66 major wastewater treatment plants (WWTPs). The fund is administered by the MDE's WQFA. The fund is financed by a bay restoration fee on users of wastewater facilities, septic systems, and sewage holding tanks. The fees on WWTP users took effect January 1, 2005, and are being collected through water and sewer bills. The fees on septic system and sewage holding tank owners took effect October 1, 2005, and are being collected by local governments.

The fund has several revenue sources and expends funds for both operating and capital program purposes. To expedite the implementation of the program, MDE intends to issue bonds backed by revenue generated under this program. Since the bay restoration fee will be applied broadly across the State, bay restoration bonds constitute State tax supported debt. The fund will consist of revenue generated from the fees, net proceeds of bonds issued by WQFA, interest or other investment income, and any additional money from any other sources. While ENR grants are the fund's primary expenditure, funds are or will also be dedicated to debt service, fee collection/administrative costs, sewer infrastructure grants, septic grants/loans, and the Department of Agriculture's cover crop program.

The timing and amount of bonds issued will depend on the actual fee revenue attained, annual funding needs, and the bond maturities and interest rates. Special fund revenues are projected to range from $56 million in fiscal 2006 (the first full year of revenue collections) to $58.9 million in fiscal 2011. Based on the current priority list and estimated capital cost of ENR upgrades, **Exhibit 3.12** shows that the program projects issuing debt in fiscal 2008 and that by fiscal 2011, $462 million of debt will be outstanding. The data was provided by MDE after the release of the CDAC's report.

Exhibit 3.12
Bay Restoration Fund
($ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Revenue Bonds Issued	$0	$50	$130	$180	$130
Debt Outstanding	0	50	178	349	462
Debt Service	0	0	5	18	35

Source: Maryland Department of the Environment

MDE estimates that the program will issue a total of $530 million through fiscal 2012. This only supports the anticipated cost to upgrade only the major WWTPs. Recent increases in estimated WWTP project construction costs raise the concern that sufficient revenue may not be available to upgrade all 66 major WWTPs with ENR by 2012.

Chapter 4. Review of the Analysis of the Capital Debt Affordability Committee

The Capital Debt Affordability Committee (CDAC) continues to employ two affordability criteria established in 1979 after analysis of available data including information from rating agencies. The affordability criteria are:

- total State tax-supported outstanding debt should not exceed 3.2 percent of Maryland personal income; and

- total State tax-supported debt service payments should not exceed 8 percent of State tax revenues.

With the application of these debt management criteria, the State intends to manage resources to meet high-priority services after the payment of debt service obligations and to preserve capacity to issue new debt in the future.

The committee expanded its focus in 1987 to include all types of State tax-supported debt (such as transportation, the Maryland Stadium Authority, Bond Anticipation Notes, and capital leases). In 2004 the committee further expanded its review to include bay restoration bonds, to be issued beginning in fiscal 2008, as tax-supported debt. Finally, the 2005 General Assembly enacted legislation, Chapters 471 and 472 Law of Maryland, recognizing Grant Anticipation Revenue Vehicle (GARVEE) debt as State tax-supported debt that must be accounted for when considering the annual authorization recommendation and in calculating the amount of outstanding tax-supported debt. While taking all tax-supported debt into consideration, the recommended fiscal 2007 debt limit of $690 million applies only to general obligation (GO) debt. The limit includes $5 million in GO bonds for the tobacco buyout program.

Beginning in 1989, the committee included higher education academic revenue bonds in its review. Although by law the committee must review the size and condition of this revenue debt, the recommended debt limit of up to $25 million for academic facilities is in addition to the limit on GO debt and is not considered as tax-supported debt nor is it subject to the 3.2 percent affordability standard.

The projections of CDAC indicate that total State tax-supported debt outstanding will remain within the 3.2 percent of Maryland personal income limit for the five-year forecast period. For fiscal 2006 through 2011, debt outstanding will reach a maximum of 3.08 percent. The committee's projections provide for 3 percent annual increases in the amount of authorized general obligation debt. The committees' long-range plan also eliminates the drop in authorizations previously planned for 2009. Collectively, these two policy changes will provide an additional $405 million of net new authorizations over what was planned by the committee for the six-year period from 2006 through 2011. By the end of fiscal 2011, total State-supported debt outstanding is expected to be almost $9.6 billion. Similarly, the projections indicate that the total State tax-supported debt service will not exceed the 8 percent limit of State tax revenues. For the same fiscal period, debt service will reach a maximum of 6.86 percent, and tax-supported debt service will increase from approximately $905 million in fiscal 2007 to over $1.2 billion in fiscal 2011.

Risk Analysis

The committee performed a risk analysis to evaluate the potential for exceeding the affordability criteria under a proposed five-year general obligation bond authorization plan. The four basic risk factors that the committee considered were:

- changes in personal income;
- changes in the definition of tax-supported debt;
- changes within the GO bond program; and
- changes in the bond issuance plans for other components, including new components of tax-supported debt.

As in prior years, the committee noted that changes in after-the-fact measurement of personal income, as compared to estimates in growth in personal income, are beyond its control. In previous years, changes in personnel income resulted in significant changes in capital program affordability. In this report, the committee acknowledges there is always a small risk of reduction in projected levels of personal income sufficient to affect affordability. However, even if personnel income growth slows substantially, the committee believes the capital program is still well within affordability limits. Despite the risk, personal income growth forecasts indicate continued growth in year-over-year personal income levels rather than declining growth rates. The committees' personal income growth projections for 2006 and 2007 are 1.06 percent and 0.54 percent respectively higher than what was projected by the committee in 2004. Even if the growth in personal income were as low as last year's estimates, the committees' analysis concludes that the personal income affordability criteria would just barely be breached in 2011 at 3.2078 percent.

The Department of Legislative Services' (DLS) current personnel income growth rate projections, which are 6.4 percent in 2006 and 6.1 percent in 2007, are somewhat higher than projected by CDAC in September 2005. This reflects the improved economic outlook that newer economic data suggests. Notwithstanding DLS' projections, even if the committees' more conservative personal income growth forecasts are assumed, debt is still affordable.

According to the committee, internal changes in the definition of what constitutes State tax-supported debt resulting from reviews of individual transactions would tend to be minor. The inclusion of Bay Restoration bonds and GARVEE bonds as tax-supported debt only marginally increases the personal income debt ratio through 2011 forecast period. However, changes in definition by the bond rating agencies or the Governmental Accounting Standards Board could have a major impact on measured affordability. The committee is unaware of any potential external changes and believes that any external changes would provide ample lead time to allow adjustments to the five-year plan.

Changes within the GO bond program were thought most likely to consist of two types. First, changes might occur to the types or costs of certain capital projects within the program. Among the factors that can cause changes in the program is the availability of PAYGO funding. However, since the committee recommends a specific dollar amount and not the use of the funds, this type of change would not affect affordability so long as the total dollar amount is not exceeded. Second, changes might occur in the rate at which authorized bonds are issued. The current report assumes a higher level of issuance from fiscal 2007 to 2011, when compared to last year's report. This year, it is projected that $3,575 million will be issued, as compared to $3,375 million planned to be issued last year.

Beyond fiscal 2006, the committee assumes a continuation of the pattern that 31 percent of bonds authorized in a given year will be issued in the following year. That assumption reflects a 1998 study of actual experience. Any systematic factors that change the rate with which bonds are sold, would affect the ratio of debt outstanding to personal income. Accelerated issuance levels for fiscal 2005 and 2006 over what was projected by the committee in 2004 is considered unlikely to reoccur as the recent deficit in the amount of bond proceeds available to support capital projects has subsided.

Changes in issuance plans for the transportation program, capital leases, the Stadium Authority, or any unknown component that would be considered State tax-supported debt have the potential to affect affordability. The committee identified several factors that might result in changes in issuance plans such as external factors that accelerate or delay a project, the expansion of existing programs or the starting of new ones that have not been accounted for in the analysis, and unknown changes in bond programs that would be considered State tax-supported debt. For instance, a proposal to construct a new horse park, estimated to cost between $75 and $100 million and currently under consideration by the Stadium Authority, would increase the amount of tax-supported debt issued and impact the affordability of the five-year capital program.

The committee's risk analysis considers the major affordability risk factors to be changes in the growth rate of personal income in a time of economic uncertainty, increased authorizations of GO bonds for school construction outside of recommended authorizations, and the possibility of an authorization of tax-supported debt to finance a horse park to be the greatest risk factor for breaching the affordability criteria limit; although the committee believes that none of these pose a serious risk. In contrast, the committee believes the other components of risk, including potential changes in the bond issuance plans of other components of State tax-supported debt, pose little pressure on the projections of capacity. However, the committee did mention that risk could result from actions taken to alter the program of authorizations within the GO capital plan.

Chapter 5. Economic Factors and Affordability Analysis

Chapter 43, Acts of 1978 created the Capital Debt Affordability Committee (CDAC). The committee's mission is to advise the Governor and General Assembly regarding the maximum amount of debt that can prudently be authorized. To evaluate State debt, the committee surveyed municipal finance specialists and developed criteria for evaluating debt affordability. To evaluate debt affordability, these two criteria were adopted:

- debt outstanding should be limited to 3.2 percent of Maryland personal income; and

- debt service should be limited to 8 percent of revenues supporting the debt service.

These criteria compare the amount of debt to economic factors that relate to the wealth of Maryland citizens (personal income) and the resources of the State (revenues). Maintaining debt levels within the guidelines set by the committee allows the State to maintain its AAA bond rating and support a growing capital program that is sustainable. The criteria are flexible enough to allow the State to adjust the program as the State's fiscal condition changes. For example, the flexibility allowed the State to prudently increase the capital program when operating funds became scarce during the recession earlier this decade. The criteria also offer the State a predictable, stable, and transparent process.

This section examines the economic factors that measure debt affordability and evaluates the CDAC's recommendation to determine affordability.

Personal Income

The Department of Legislative Services' (DLS) estimates of personal income differ from those of CDAC. **Exhibit 5.1** shows that DLS is estimating higher personal income than CDAC beginning in calendar 2005. DLS' higher personal income projections are attributable to improved economic performance suggested by recent economic data.

Changes in personal income can have a large impact on the affordability of the State's debt level. Improvements in personal income levels have the effect of improving the affordability picture. In contrast, lower personal income results in higher ratios of debt outstanding for any given level of debt. Levels of outstanding debt that were projected to be affordable in past years may suddenly be close to or over the limit if poor economic conditions result in sizable downward revisions.

Exhibit 5.1
Maryland Personnel Income – Historical Data and Projections
Comparison of DLS and CDAC Projections
($ in Millions)

Calendar Year	DLS Personal Income	Percent Change	CDAC Personal Income	Percent Change	Difference
2004	$220,261	6.7%	$218,138	5.82%	$2,123
2005	233,658	6.1%	230,479	5.66%	3,179
2006	248,513	6.4%	243,462	5.63%	5,051
2007	263,626	6.1%	256,684	5.43%	6,942
2008	279,030	5.8%	270,394	5.34%	8,636
2009	294,345	5.5%	283,806	4.96%	10,539
2010	310,234	5.4%	297,006	4.65%	13,228
2011	326,900	5.4%	310,682	4.60%	16,218

Source: Capital Debt Affordability Committee: *Capital Debt Affordability Committee Report*, September 2005

Revenue Projections

Exhibit 5.2 shows that DLS' revenue projections exceed those of CDAC through fiscal 2011. DLS' revenue projections are higher because of improved economic performance suggested by recent economic data. Revenue levels are factored into the debt service criterion. Higher revenues result in lower ratios of debt service to revenues and increase debt service capacity.

Exhibit 5.2
Revenue History and Projections
($ in Millions)

Fiscal Year	General Fund	Property Taxes	Use of Premium	Trans.	GARVEE	Stadium Related	Bay Rest. Fund	Total DLS Revenues	CDAC Revenues	Diff.
2006	$12,097	$568	$79	$2,035	$0	$32	$0	$14,810	$14,415	$395
2007	12,686	609	0	2,084	43	32	0	15,454	14,915	539
2008	13,329	656	0	2,094	43	32	0	16,154	15,472	682
2009	14,027	685	0	2,141	80	31	5	16,969	16,186	783
2010	14,744	722	0	2,178	80	31	17	17,773	16,910	863
2011	15,482	764	0	2,216	86	31	35	18,614	17,686	928

Rest. = Restoration

Source of Estimates
General Fund: Department of Legislative Services
Property Tax: *Capital Debt Affordability Committee Report*, September 2005
Use of Premium: *Capital Debt Affordability Committee Report*, September 2005
Transportation: Department of Legislative Services
Stadium: *Capital Debt Affordability Committee Report*, September 2005
Capital Debt Affordability Committee Revenues: *Capital Debt Affordability Committee Report*, September 2005

Affordability Analysis

Exhibits 5.3 and **5.4** incorporate the general obligation debt (GO) limit recommended by CDAC, the DLS estimated debt levels for GO and transportation bonds, along with the personal income and revenues estimated by DLS to determine compliance with the established guidelines for debt affordability.

Exhibit 5.3 shows that, for the forecast period, debt outstanding as a percent of personal income peaks at 2.94 percent in fiscal 2010. The forecast assumes the authorizations recommended by CDAC and an issuance stream consistent with CDAC policies.

Exhibit 5.4 shows that the debt service as a percent of revenues increases throughout the forecast period. Debt service as a percent of revenues peaks at 6.52 in fiscal 2011. If the ratio is increasing, as it is expected to, debt service costs outpace revenues and become a larger share of expenditures.

Exhibit 5.3
State Tax-supported Debt Outstanding
Components and Relationship to Personal Income

Fiscal Year	General Obligation (a)	Department of Transportation Consolidated (b)	County	Total	GARVEE	Capital Leases	Stadium Authority	Bay Restoration Bonds	Total Tax-supported Debt
				State Tax-supported Debt Outstanding ($ in Thousands)					
2001	$3,450,900	$648,050	$3,830	$651,880	$0	$135,507	$285,975	$0	$4,524,262
2002	3,544,178	714,150	3,155	717,305	0	186,238	277,995	0	4,725,716
2003	3,932,493	961,245	2,440	963,685	0	193,136	323,240	0	5,412,554
2004	4,102,278	1,185,650	1,675	1,187,325	0	198,585	320,955	0	5,809,143
2005	4,511,826	1,069,945	865	1,070,810	0	175,062	309,195	0	6,066,893
2006	4,868,471	1,218,475	0	1,218,475	375,000	208,260	296,280	0	6,966,486
2007	5,137,776	1,366,050	0	1,366,050	351,780	207,577	282,340	0	7,345,523
2008	5,409,466	1,537,060	0	1,537,060	652,340	190,442	267,415	50,000	8,106,723
2009	5,672,939	1,663,050	0	1,663,050	606,490	179,704	252,205	177,683	8,552,071
2010	5,920,361	1,850,355	0	1,850,355	608,235	171,286	236,010	349,225	9,135,472
2011	6,165,366	1,996,185	0	1,996,185	554,390	161,943	218,755	462,003	9,558,642
				State Tax-supported Debt Outstanding as a Percent of Personal Income (Affordability Criteria = 3.2%)					
2001	1.80	0.34	0.00	0.34	0.00	0.07	0.15	0.00	2.36
2002	1.78	0.36	0.00	0.36	0.00	0.09	0.14	0.00	2.38
2003	1.90	0.47	0.00	0.47	0.00	0.09	0.16	0.00	2.62
2004	1.86	0.54	0.00	0.54	0.00	0.09	0.15	0.00	2.64
2005	1.93	0.46	0.00	0.46	0.00	0.07	0.13	0.00	2.60
2006	1.96	0.49	0.00	0.49	0.15	0.08	0.12	0.00	2.80
2007	1.95	0.52	0.00	0.52	0.13	0.08	0.11	0.00	2.79
2008	1.94	0.55	0.00	0.55	0.23	0.07	0.10	0.02	2.91
2009	1.93	0.57	0.00	0.57	0.21	0.06	0.09	0.06	2.91
2010	1.91	0.60	0.00	0.60	0.20	0.06	0.08	0.11	2.94
2011	1.89	0.61	0.00	0.61	0.17	0.05	0.07	0.14	2.92

(a) Reflects presumed new authorizations as follows:

General Assembly Session	2006	2007	2008	2009	2010	2011
For Fiscal Year	2007	2008	2009	2010	2011	2012
($ in Millions)	$690	$710	$730	$745	$770	$795

(b) Does not include the following:

(1) The Transportation Authority investment of $11.9 million for the development of Berth 4 at the Seagirt Marina Terminal – the Maryland Department of Transportation is repaying this amount in annual payments of $567,280 including interest over a 33-year period.

(2) Financing the construction of the Masonville Auto Terminal during fiscal 1999 and 2000 in the amount of $20 million to be repaid in annual payments of $1,674,0000 including interest over a 20-year period.

Assumptions: ($ in Millions)	2006	2007	2008	2009	2010	2011
GO Issuances	$750	$675	$700	$725	$725	$750
MDOT Issuances	155	215	240	205	270	240
GARVEE	0	375	0	325	0	50
Stadium Authority Issuances	9	0	0	0	0	0
Capital Leases – Equipment and EPC	45	35	35	35	35	35
Bay Restoration Bond Issuances	0	0	50	130	170	160
Personal Income ($ in Billions)	248.5	263.6	279.0	294.3	310.2	326.9

Source: Department of Legislative Services

Exhibit 5.4
State Tax-supported Debt Service
Components and Relationship to Revenues

Fiscal Year	General Obligation (a)	MDOT Consolidated (b)(c)	GARVEE	Capital Leases	Stadium Authority	Bay Restoration Bonds	Total Tax-supported Debt Service
			State Tax-supported Debt Service ($ in Thousands)				
2001	$459,358	$109,674	$0	$30,421	$27,622	$0	$627,075
2002	470,949	113,178	0	37,979	27,383	0	649,489
2003	496,870	128,694	0	46,152	27,035	0	698,751
2004	536,819	134,910	0	52,117	27,333	0	751,179
2005	553,783	153,655	0	52,239	30,480	0	790,157
2006	625,208	145,872	0	40,912	31,713	0	843,705
2007	657,169	130,586	42,908	45,404	31,725	0	907,792
2008	697,334	140,709	42,908	55,400	31,888	0	968,239
2009	746,855	159,223	80,098	57,991	31,327	4,817	1,080,311
2010	779,375	172,051	80,096	55,143	31,388	17,342	1,135,395
2011	822,971	192,704	85,817	51,250	31,477	34,683	1,218,903
			State Tax-supported Debt Service as a Percent of Revenues (Affordability Criteria = 8.0%)				
2001	3.92	0.94	0.00	0.26	0.24	0.00	5.36
2002	4.11	0.99	0.00	0.33	0.24	0.00	5.66
2003	4.39	1.14	0.00	0.41	0.24	0.00	6.18
2004	4.22	1.06	0.00	0.41	0.21	0.00	5.91
2005	3.89	1.08	0.00	0.37	0.21	0.00	5.55
2006	4.22	0.98	0.00	0.28	0.21	0.00	5.69
2007	4.25	0.84	0.28	0.29	0.20	0.00	5.87
2008	4.31	0.87	0.27	0.34	0.20	0.00	5.98
2009	4.39	0.94	0.47	0.34	0.18	0.03	6.35
2010	4.37	0.96	0.45	0.31	0.18	0.10	6.36
2011	4.40	1.03	0.46	0.27	0.17	0.19	6.52

(a) Reflects payments for Qualified Zone Academy Bonds (QZABs) issued in September 2001 and October 2004. The Interagency Committee on School Construction has not indicated when QZABs authorized in 2005 will be issued. DLS projects they will be issued in the last half of fiscal 2006.

(b) Does not include debt service on county transportation bonds. Repayments from counties equal or exceed debt service requirements.

(c) Does not include the following:

(1) The Transportation Authority investment of $11.9 million for the development of Berth 4 at the Seagirt Marina Terminal – the Maryland Department of Transportation is repaying this amount in annual payments of $567,280, including interest over a 33-year period. (2) Financing the construction of the Masonville Auto Terminal during fiscal 1999 and 2000 in the amount of $20 million to be repaid in annual payments of $1,674,000 including interest over a 20-year period.

Reflects presumed new authorizations as follows –

	2007	2008	2009	2010	2011
($ in Millions)	$710	$730	$745	$770	$795

Source: Department of Legislative Services

Exhibit 5.5 shows that debt outstanding ratios based on DLS personal income estimates are slightly lower than those estimated by CDAC throughout the forecast period. As previously noted, the differences are attributable to recent economic data. The DLS estimates provide the State with more debt capacity than the CDAC estimates.

Exhibit 5.5
State Debt to Personal Income
Comparison of DLS and CDAC Estimates

Fiscal Year	DLS	CDAC
2006	2.80%	2.87%
2007	2.79%	2.84%
2008	2.91%	2.96%
2009	2.91%	2.98%
2010	2.94%	3.04%
2011	2.92%	3.08%

Source: *Capital Debt Affordability Committee Report*, September 2005

Similarly, **Exhibit 5.6** shows that debt service ratios based on the DLS baseline forecast of general fund revenues are slightly lower than those estimated by CDAC due to revenue projections.

Exhibit 5.6
State Debt Service to State Revenues
Comparison of DLS and CDAC Estimates

Fiscal Year	DLS	CDAC
2006	5.69%	5.85%
2007	5.87%	6.07%
2008	5.98%	6.24%
2009	6.35%	6.64%
2010	6.36%	6.67%
2011	6.52%	6.86%

Source: *Capital Debt Affordability Committee Report,* September 2005

For both affordability criteria, the forecasts for personal income and general funds provide capacity under the projected annual debt limits.

Declining Unused Capacity

As in recent years, the State still has a substantial amount of unused debt capacity. In January 2005, Department of Budget and Management data suggested that the State had sufficient capacity to issue almost $1.5 billion in State debt. **Exhibit 5.7** shows that while the unused debt capacity is still substantial, it has declined to $896 million. (The comparison is made in fiscal 2010 since that is the year in which the State is closest to the debt limit.)

Exhibit 5.7
Unused State Debt Capacity Is Reduced
Comparison of January 2005 and Current DLS Estimates
($ in Millions)

Debt Outstanding June 30, 2010	January 2005	November 2005	Variance
GO Bond	$5,760	$5,920	$160
Capital Leases	93	171	79
Transportation Bonds	1,760	1,850	90
Grant Anticipation Revenue Vehicles (GARVEEs)	0	608	608
Stadium Authority Bonds	236	236	0
Bay Restoration Bonds	339	349	10
Total Debt Outstanding	**$8,188**	**$9,135**	**$947**
Estimated Personal Income in 2010	**$301,297**	**$310,234**	**$8,937**
Unused Capacity	**$1,453**	**$792**	**-$661**
FY 2010 Debt Outstanding as % of Personal Income	**2.72%**	**2.94%**	**0.23%**

Source for January 2005 data: Department of Budget and Management

The decline in unused capacity is attributable to projected increases in GO bonds and the inclusion of GARVEE bonds as State debt. As discussed in Chapter 3, the committee expanded out-year GO bond authorizations. This is expected to increase issuances and reduce unused capacity. In response to rating agencies' comments, the State adopted a policy to include GARVEEs as State-supported debt.

These increased issuances were offset somewhat by increased personal income estimates. The fiscal 2010 personal income estimates increase by almost $9 billion, providing an additional $285 million in capacity.

Chapter 6. Non-tax-supported Debt

In addition to the seven types of tax-supported debt that Maryland issues, there are various forms of non-tax-supported debt that are issued by State agencies and non-state public purpose entities. While this debt is not backed by the full faith and credit of the State and is not included within the tax-supported debt criteria, a default in payment of debt service on this debt could negatively impact other Maryland debt.

Non-tax-supported debt generally takes the form of either a project/program revenue debt or conduit debt, as discussed below:

- **Revenue Bonds:** Revenue bonds are bonds issued to raise funds for a specific project or program. The debt service on these bonds is generally repaid using revenues generated through the operation of the project or program for which the bonds were sold. For example, the Maryland Transportation Authority (MdTA) issues project revenue bonds to finance the cost of constructing revenue generating transportation facilities, and MdTA then repays the bonds using the revenues generated through the tolls charged to drivers for the use of the facilities.

- **Conduit Debt:** Conduit debt is debt that agencies or authorities issue on behalf of clients. Clients could include local governments, nonprofit organizations, or private companies. When an agency or authority serves as a conduit issuer, the bonds it issues may not be obligations of the issuing entity. Should the client for whom the bonds are issued be unable to meet debt service obligations on their bonds, the issuing entity is not necessarily obligated to make the debt payments. In such circumstances, the issuing agency may take the client's property into receivership or exercise other contractual provisions to meet the debt service. Agencies and authorities in the State that serve primarily as conduit issuers include the Maryland Economic Development Corporation (MEDCO), the Maryland Health and Higher Educational Facilities Authority (MHHEFA), and the Maryland Industrial Development Financing Authority.

Revenue and Private Activity Bonds

Debt service on revenue bonds is generally derived from the revenue generated from facilities built with the bond proceeds. The Department of Housing and Community Development's Community Development Administration (CDA) makes housing loans with revenue bond proceeds, and the mortgage payments help pay debt service. Likewise, MdTA constructs toll facilities with bond proceeds and the tolls collected pay off the bonds. Other State agencies issue bonds for various purposes. This agency debt is funded through private activity bonds. CDA, the Maryland Industrial Development Financing Authority, and the Maryland Energy Finance Authority issue private activity bonds to fund projects. These bonds are subject to the unified volume cap set by Congress in the Tax Reform Acts of 1986.

Exhibit 6.1 provides the calendar 2001 through 2005 figures for the amount of available tax-exempt bond authority and the level of issuances made under the volume cap limits. From calendar 2002 through 2004, total issuances under the volume cap declined. The recent downturn in the national and Maryland economies, coupled with changes in the federal allocation guidelines, simultaneously made tax-exempt financing less desirable and practical in the highly regulated tax-exempt financing marketplace and produced substantial increases in annual allocation and available volume cap levels. Estimates for 2005 indicated a much stronger tax-exempt financing marketplace. According to the Department of Business and Economic Development, the designated State allocating authority, issuances of $660 million are planned for 2005, which is more than three times the amount issued in each of the previous three years.

Exhibit 6.1
Allocation of Private Activity Bonds
Calendar 2001 – 2005
($ in Millions)

	2001	2002	2003	2004	2005 Est.
Fund Sources					
Annual Cap	$331.0	$403.1	$409.4	$440.7	$444.6
Carry Forward from Prior Years	211.0	213.0	455.6	710.0	945.4
Total Capacity Available	**$542.0**	**$616.1**	**$865.0**	**$1,150.7**	**$1,390.0**
Issuances					
Mortgage Revenue Bonds	$135.6	$0.9	$20.7	$84.9	$327.6
Multifamily Housing	130.0	77.9	130.3	109.5	69.9
Housing Not Broken Out	0.0	54.1	0.0	0.0	0.0
Industrial Development Bonds	38.4	15.8	4.0	10.9	72.1
Exempt Facilities	25.0	11.8	0.0	0.0	0.0
Student Loans	0.0	0.0	0.0	0.0	0.0
Mortgage Credit Certificates	0.0	0.0	0.0	0.0	0.0
Local Government Nonallocated	0.0	0.0	0.0	0.0	177.4
Other	0.0	0.0	0.0	0.0	13.6
Total Issuances	**$329.0**	**$159.6**	**$155.0**	**$205.3**	**$660.6**
Carry Forward	$213.0	$455.6	$710.0	$945.4	$729.4

Source: Bond Market Association; Department of Business and Economic Development

Debt Outstanding

Containing the amount of non-tax-supported agency debt has been a consistent concern of both the General Assembly and the Capital Debt Affordability Committee. During the 1989 session, the General Assembly passed SB 337 in an attempt to establish a measure of control over agency debt. This legislation was vetoed by the Governor who addressed the issue through the issue of Executive Order 01.01.1989.13 that established a procedure whereby the Governor set a revenue bond debt ceiling each year and allocated the debt allowance among the State agencies. The Department of Budget and Management (DBM) was tasked with administering the process and was required to submit a report annually on the amount of agency debt outstanding. During the 1997 interim, a workgroup comprised of DBM staff and staff from agencies that issue revenues bonds, met to review the provisions of the 1989 executive order and make recommendations for improvement. The workgroup recommended removing higher education institutions from the process because their levels of debt are already limited by statute. Additionally, the CDA Infrastructure Program was recommended for removal from the process because debt of that program is issued on behalf of local governments and is not a debt of the State. Finally, the workgroup recommended changes in reporting dates and notification requirements. It was decided that prior notification of issuances need to be made only for issuances of $25 million or more. On February 10, 1998, the Governor instituted the recommendations of the workgroup by signing Executive Order 01.01.1998.07 superceding the 1989 process.

Exhibit 6.2 summarizes the increase in debt outstanding for various categories between fiscal 1995 and 2005. A table containing debt outstanding by year for the individual agencies included in the summary is included as **Appendix 3**.

Exhibit 6.2
Debt Outstanding as of June 30
($ in Millions)

	1995	2005	% Change
Agency debt subject to issuance cap	$665.5	$882.2	33%
Agency debt not subject to issuance cap	3,253.3	3,915.2	20%
General obligation and State lease debt	2,744.3	4,686.9	71%
Transportation debt	1,047.5	1,069.9	2%
Authorities and corporations without caps	2,317.6	7,212.2	211%
Total	**$10,028.2**	**$17,766.4**	**77%**

Source: Department of Budget and Management report, *Debt Issued by Maryland State Agencies and Independent Authorities, fiscal 2005*

Between fiscal 1995 and 2005, general obligation bond and State capital lease debt outstanding has increased by 77 percent. Over the same period, agency debt subject to the Governor's issuance cap has increased $217 million, an increase of 33 percent. Most of the increase is attributable to the recent issuance activity by MdTA. Agency debt that is not subject to the Governor's cap (excluding debt of the Maryland Industrial Financing Authority for which debt outstanding figures for years prior to 1997 is unavailable) has grown by $662 million, an increase of 20 percent. Similarly, authorities/corporations without caps debt increased by close to $4.8 billion, a 112 percent increase.

Growth in Non-tax-supported Debt Burden

Exhibit 6.3 shows the total amount and the average annual growth in outstanding non-tax-supported debt for fiscal 1999, 2002, and 2005 (this excludes higher education academic and auxiliary debt which is discussed in the next section). From fiscal 1999 through 2002, outstanding non-tax-supported debt increased at an average annual rate of 11.2 percent which exceeded the growth in personal income for this time period which increased at an average annual rate of 6.4 percent. From fiscal 2002 through 2005, the rate of growth in outstanding non-tax-supported debt slowed substantially to just 2.2 percent, which was less than the 5.2 percent average annual growth in personal income for this time period.

Most of the growth is attributable to the increased issuance activity for MEDCO and MHHEFA.

Exhibit 6.3
Agency Debt Outstanding[1]
Fiscal 1999 – 2005
($ in Millions)

Agency	FY 1999	FY 2002	FY 2005	Avg. Annual Increase FY 99-02	Avg. Annual Increase FY 02-05
MD Environmental Service	$34.0	$36.5	$30.5	2.4%	-5.8%
MD Food Center Authority	6.9	0.0	0.0		0.0%
MD Transportation Authority	344.5	668.8	763.6	24.8%	4.6%
Water Quality Financing Administration	138.1	115.9	88.2	-5.7%	-8.7%
Department of Housing and Community Development Administration	2,554.6	2,797.5	2,317.1	3.1%	-6.1%
MD Industrial Dev. Financing Authority[2]	647.4	581.4	395.0	-3.5%	-12.1%
MD Dept. of Transportation Certificates of Participation and County Revenue Bonds	77.4	78.1	81.5	0.3%	1.4%
MD Economic Development Corporation	321.1	1,077.7	1,667.8	49.7%	15.7%
Health and Higher Education Facility Authority	3,236.6	4,265.4	5,544.3	9.6%	9.1%
Total	**$7,420.6**	**$10,202.7**	**$10,888.0**	**11.2%**	**2.2%**

[1] Excludes higher education institution debt discussed later in this chapter.

[2] Legislation, effective January 2002, abolished the Maryland Energy Financing Administration. The outstanding debt is now reflected under the Maryland Industrial Development Financing Authority.

Debt Service on Academic and Auxiliary Revenue Bonds

Chapter 93, Acts of 1989 gave Morgan State University (MSU), St. Mary's College of Maryland (SMCM), and the University System of Maryland (USM) the authority to issue bonds for academic and auxiliary facilities. Chapter 208, Acts of 1992 granted Baltimore City Community College (BCCC) the authority to issue bonds for auxiliary facilities only. Academic facilities are primarily used for instruction of students. Auxiliary facilities are those that produce income from fees charged for the use of the facility. A residential dormitory is an example of an auxiliary facility. Debt service on auxiliary and academic debt may be paid from auxiliary and academic fees, a State appropriation expressly authorized for that purpose, or revenues from contracts, gifts, or grants.

The statute specifies that academic facilities must be expressly approved by an Act of the General Assembly that determines both the project and bond issue amount. Each year, USM introduces legislation entitled Academic Facilities Bonding Authority that lists the specific academic projects that require authorization. This legislation may also increase the USM total debt limit when warranted. The USM debt limit is $1.025 billion, the MSU limit is $77 million, the SMCM limit is $45 million, and the BCCC limit is $15 million.

University System of Maryland

In 1995 the USM Board of Regents adopted a debt capacity policy recommended by consultants that limits the percentage of unrestricted funds and mandatory transfers used for debt service to 5.5 percent. In 2001 a new debt capacity study was conducted that reaffirmed 5.5 percent the maximum annual debt service percentage. **Exhibit 6.4** shows the USM debt service to unrestricted funds ratios for fiscal 2002 through 2011. Including debt issued in fiscal 2006, total debt service will be approximately $105 million, or 4.2 percent of unrestricted funds and mandatory transfers which is below the recommended limit. The forecast does indicate a continuing decline in the ratio in the next five years with fiscal 2006 projected to produce the highest percentage through fiscal 2011.

While the policy of limiting debt service to 5.5 percent of unrestricted funds and mandatory transfers currently factors favorably into rating agency assessment of the system's debt, the rating agencies have expressed concerns regarding USM's liquidity (liquidity is defined as the ratio between expendable resources and debt) as compared to other top-rated colleges and universities. To address these concerns, USM, in consultation with its financial advisors, is developing a new debt capacity policy that includes liquidity measures. The USM Board of Regents is expected to approve the new policy, which will include a ratio of expendable resources (defined as unrestricted assets of USM and its affiliated foundation with adjustments for certain long-term liabilities) to debt outstanding in January 2006. Under this policy, USM is committed to maintaining expendable resources that are no less than 50 percent of debt outstanding. **Exhibit 6.5** shows fiscal 2001 through 2006 USM expendable resources to debt outstanding ratios.

Exhibit 6.4
University System of Maryland Debt Service as Related to Unrestricted Funds
Fiscal 2002 – 2011
($ in Thousands)

Fiscal Year	Academic & Auxiliary Debt Outstanding	Academic & Auxiliary Debt Service	Unrestricted Expenditures Plus Mandatory Transfers	Ratio of Debt Service to Unrestricted Expenditures Plus Mandatory Transfers
2002	$796,665	$78,607	$2,116,275	3.7%
2003	855,142	83,679	2,153,227	3.9%
2004	960,885	89,464	2,234,731	4.0%
2005	965,228	96,224	2,324,120	4.1%
2006 Estimated	1,017,905	104,757	2,479,090	4.2%
2007 Estimated	1,034,109	109,787	2,627,835	4.2%
2008 Estimated	1,042,860	114,008	2,785,506	4.1%
2009 Estimated	1,045,315	118,161	2,952,636	4.0%
2010 Estimated	1,041,560	117,606	3,129,794	3.8%
2011 Estimated	1,036,210	116,821	3,317,582	3.5%

Source: University System of Maryland

Exhibit 6.5
Summary of Expendable Resources to Debt Outstanding for the University System of Maryland
($ in Millions)

Fiscal Year	Expendable Resources	Debt Outstanding	Ratio of Expendable Resources to Debt Outstanding
2001	$524.9	$802.7	65.4%
2002	500.4	797.0	62.8%
2003	514.7	960.0	53.6%
2004	646.9	998.1	55.9%
2005	654.6	1,012.8	55.4%
2006 Estimated	666.1	1,018.3	55.1%

Source: University System of Maryland, October 2005

Morgan State University

As shown in **Exhibit 6.6**, MSU has $66.4 million of combined outstanding academic and auxiliary debt in fiscal 2006. This consists of $9.2 million in academic debt and $57.4 million in auxiliary debt. The ratio of debt service to unrestricted funds and mandatory transfers remains below the 5.5 percent threshold through the fiscal 2006 to 2011 planning period. However, because this ratio is expected to be between 5.1 and 5.3 percent between fiscal 2006 and 2008, any unexpected downward adjustment to the growth in unrestricted expenditures could result in a ratio above the 5.5 percent threshold.

The estimates for the amount of outstanding debt include MSU's tentative plan to issue an additional $18 million of auxiliary debt in fiscal 2007 to enable the university to pursue future housing expansion opportunities as they may become available; although no specific proposal is currently under consideration. Based on the amount of debt outstanding for fiscal 2006, MSU only has approximately $11.6 million of debt capacity available within the university's $77 million statutory debt limit. Should MSU wish to pursue its tentative housing expansion plan, legislation to increase the university's $77 million debt limit would be required.

Exhibit 6.6

Morgan State University Debt Service as Related to Unrestricted Funds

Fiscal 2002 – 2011

($ in Thousands)

Fiscal Year	Academic & Auxiliary Debt Outstanding	Academic & Auxiliary Debt Service	Unrestricted Expenditures Plus Mandatory Transfers	Ratio of Debt Service to Unrestricted Expenditures Plus Mandatory Transfers
2006 Estimated	$66,413	$6,458	$127,566	5.1%
2007 Estimated	82,843	7,069	133,306	5.3%
2008 Estimated	80,970	7,189	139,305	5.2%
2009 Estimated	79,044	7,296	145,574	5.0%
2010 Estimated	77,074	7,325	152,125	4.8%
2011 Estimated	75,077	7,354	158,970	4.6%

Source: Morgan State University

St. Mary's College of Maryland

SMCM does not have any outstanding academic debt. Auxiliary debt totals $39.4 million in fiscal 2006 and is expected to decrease to $33.5 million by fiscal 2011.

Since fiscal 2004, SMCM has exceeded the 5.5 percent debt ratio in order to build more residential buildings to house increasing enrollment. Currently, SMCM has a 5.6 percent ratio of debt to unrestricted expenditures and mandatory transfers. As shown in **Exhibit 6.7**, while the ratio is still above the 5.5 percent threshold, it has declined in fiscal 2004 and 2005 and is expected to continue to decline though 2011 to well below the 5.5 percent threshold. The new residence hall is currently full, and since the debt for the building will be paid out of auxiliary revenues, exceeding the ratio is not expected to hurt the college's credit rating.

Exhibit 6.7
St. Mary's College of Maryland Debt Service as Related to Unrestricted Funds
Fiscal 2002 – 2011
($ in Thousands)

Fiscal Year	Academic & Auxiliary Debt Outstanding	Academic & Auxiliary Debt Service	Unrestricted Expenditures Plus Mandatory Transfers	Ratio of Debt Service to Unrestricted Expenditures Plus Mandatory Transfers
2002	$27,778	$1,198	$36,014	3.3%
2003	40,603	1,978	40,225	4.9%
2004	39,678	2,551	42,410	6.0%
2005	40,565	2,797	47,981	5.8%
2006 Estimated	39,445	2,799	50,346	5.6%
2007 Estimated	38,350	2,807	52,360	5.4%
2008 Estimated	37,205	2,799	54,454	5.1%
2009 Estimated	36,025	2,799	56,632	4.9%
2010 Estimated	34,800	2,792	58,897	4.7%
2011 Estimated	33,535	2,789	61,253	4.6%

Source: St. Mary's College of Maryland

Chapter 7. Issues and Recommendations

This section discusses issues related to Maryland debt and debt management. These issues address major policy concerns or funding recommendations. Specific issues are:

- Currently, general obligation (GO) debt service is supported by property taxes, proceeds generated from bond sale premiums, and other revenues. In the short term, bond sale premiums coupled with State property tax revenue attainment provide sufficient revenues to support GO bond debt service payments. Interest rates are expected to rise, thus eliminating the bond sale premium. However, new estimates project that State property tax revenues will increase more than debt service payments at the current State property tax rate, which is $0.132 per $100 of assessable base. Because of the increase in revenues, current estimates assume that there will be sufficient property tax revenues to support GO bond debt service, through fiscal 2011.

- The State's capital program is supported by GO bonds. By limiting private use and private activity purposes the State is able to issue tax-exempt bonds. State policy has been to provide operating budget support for private use and private activity programs and projects. In response to the fiscal crisis, the State authorized GO bonds, instead of operating funds, for these programs and projects. Consequently, the State has issued $45 million in taxable debt in 2005. Taxable debt issuance costs are $1.6 million more than similarly structured tax-exempt debt. **It is recommended that the Administration appropriate operating budget funds for private use and private activity programs and projects. It is also recommended that the Spending Affordability Committee (SAC) exclude these operating funds from the 2006 spending limit.**

- The Task Force to Study Public School Facilities concluded that many of Maryland's public schools do not meet all minimum required standards as of July 2003. To bring all schools up to these standards, it is estimated to require $2 billion in State funds. This requires $250 million per year from the 2005 through 2012 sessions. In 2005 the State met its goal and authorized $250 million for public school construction. Current plans provide an additional $750 million, requiring the State to find an additional $1 billion to meet the spending goal. The Capital Debt Affordability Committee (CDAC) has increased authorizations, which provides an additional $550 million that could support public school construction.

Analysis of Revenues Supporting Debt Service

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 generated by fund balances and repayments for local bonds.

When ABF has not generated sufficient revenues to support all of debt service, general funds have subsidized debt service.

Until fiscal 2003, State property taxes remained unchanged at $0.084 per $100 of assessable base. At this level, State property taxes supported approximately 55 to 60 percent of debt service costs. The State did not appropriate general funds for the ABF in the fiscal 2004 budget. To eliminate the ABF revenue shortfall, the Board of Public Works increased the State property tax rate to $0.132 per $100 of assessable base. With these actions, the State moved from maintaining a constant property tax rate and funding any remaining debt service with general funds to funding the entire debt service payment with property taxes (as well as some smaller revenue sources) and without general funds. As in fiscal 2004, the fiscal 2005 and 2006 budgets do not include any general funds for GO bond debt service.

Bond Sale Premiums Provide a Substantial Annuity Bond Fund Balance That Keeps State Property Tax Rates Low

Keeping State property tax rates at $0.132 per $100 of assessable base provides sufficient revenues to fund debt service. The ABF has benefited from the high fund balances that bond sale premiums[1] have generated. Since 2000, GO bond sales have generated $325 million in bond sale premiums, which have been deposited into ABF to support debt service payments. By the end of fiscal 2006, the ABF balance is projected to be $145 million.

Bond sale premiums allowed the State to keep its property tax rate lower than it otherwise might have been. For example, fiscal 2005 generated $514 million in State property tax receipts which was able to support $554 million in debt service costs by reducing the fund balance. Most economic forecasts expect interest rates to rise over the next few years, which will eliminate the premium and require the State to either raise property tax rates or appropriate general funds for debt service.

Increased Real Estate Values Continued in Fiscal 2005

In recent years, State property taxes have also been strong because of increases in real estate property values. **Exhibit 7.1** shows that the median sales price of a home in Maryland has increased from approximately $152,000 in fiscal 2001 to approximately $265,000 in fiscal 2005. These increased sales prices have driven up the State assessable base, thus increasing property tax collections.

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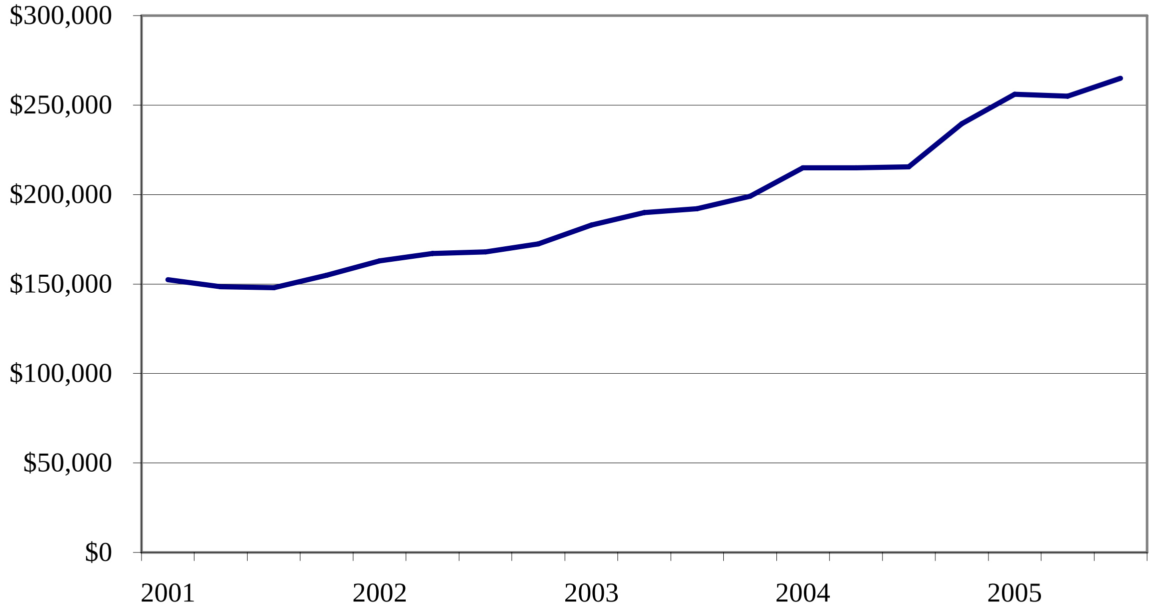
[1]Bond sales generate a premium when the market interest rate, as measured by the true interest cost, is less than the coupon interest rate that the bond pays to bondholders. Under these conditions, the bonds sell at a premium and the State receives the additional proceeds at the time of the bond sale. By law the proceeds from the premiums are deposited into the ABF and used to pay debt service.

Exhibit 7.1
State Property Taxes
Increase in the Median Sales Price of Improved Residential Properties
First Quarter of Fiscal 2001 to Third Quarter of Fiscal 2005



Source: Department of Assessments and Taxation, Department of Budget and Management, and Department of Legislative Services

In November 2005, the State Department of Assessments and Taxation revised its estimates of the State's property tax assessable base. The total value of Maryland's projected real property value increased by $35 billion in fiscal 2007. The estimate increased 7.2 percent as total real property values are expected to exceed $523 billion.

Annuity Bond Fund Revenues Sufficient to Support Debt Service

Exhibit 7.2 shows that, if State property tax rates are maintained at $0.132 per $100 of assessable base, revenues supporting debt service are sufficient to fully fund debt service beginning through fiscal 2011. The ABF has benefited from bond sale premiums, which generated high fund balances, and increased assessments, which resulted in substantial upward revisions to revenue projections.

Exhibit 7.2
Annuity Bond Fund
Property Tax Revenues Constant at $0.132 per $100 of Assessable Base
($ in Millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Special Fund Revenues						
Property Tax Receipts	$571	$655	$742	$746	$789	$834
Bond Sale Premiums	94	0	0	0	0	0
Other Revenues	4	3	2	1	1	1
ABF Fund Balance Transferred from Prior Year	101	145	146	193	194	204
Subtotal Special Fund Revenues Available	**$770**	**$803**	**$890**	**$940**	**$983**	**$1,039**
General Fund Revenues	0	0	0	0	0	0
Total Revenues	**$770**	**$803**	**$890**	**$940**	**$983**	**$1,039**
Projected Debt Service Expenditures	**$625**	**$657**	**$698**	**$746**	**$779**	**$822**
ABF End-of-year Fund Balance	**$145**	**$146**	**$193**	**$194**	**$204**	**$216**

Source: Department of Assessments and Taxation, Department of Budget and Management, and Department of Legislative Services

In the short term, bond sale premiums make up for the gap in revenues. For example, State property taxes are projected to generate $568 million in fiscal 2006 while debt service expenditures total $625 million. There are sufficient revenues to support debt service in spite of expenditures exceeding State property tax revenues because of the high fund balance that the premiums have generated. By the end of the forecast period in fiscal 2011, the ABF is expected to have a $216 million fund balance.

In the out-years, annual property tax receipts are projected to exceed annual debt service. In fiscal 2008, debt service payments are projected to be $698 million, and State property tax receipts are projected to be $742 million if the State property tax rate remains at $0.132 per $100 of assessable base.

While the growth is likely to slow if the growth in real estate slows, as it is expected to do, it is unlikely that collections will decline. To mitigate the effect of substantial growth in real estate values, the State currently has a Homestead Tax Credit program, which limits property assessment increases to 10 percent each year. Consequently, all increases exceeding 10 percent are taxed as though they only increased 10 percent.

The effect of the homestead credit on State revenues is substantial. In fiscal 2011, the credit is expected to reduce assessments by over $110 billion, thus reducing collections by over $150 billion. Because of these substantial credits, even if property tax revenues estimates are revised downward, the State revenue collections are still likely to increase since under-attaining revenue collections would probably also result in a corresponding reduction in the Homestead Tax Credit. The net effect would be little or no reduction in revenues generated, since the State is not collecting the assessments affected by the Homestead Tax Credit. The bottom line is that the credit is a massive hedge against declining property tax assessments.

Implementing State Property Tax Relief Is Projected to Result in Out-year Subsidy to Annuity Bond Fund

Rising assessments, coupled with increased State property tax rates, have increased the amount of State property taxes paid for many Marylanders. In response to the rising tax payments, there have been proposals to reduce property tax rates. The current State tax rate ($0.132 per $100 of assessable base) is sufficient to support debt service in the out-years, and it appears that some tax relief may be possible without providing any general fund subsidies in the near term.

Exhibit 7.3 shows that a 1-cent reduction does not require any general fund subsidies until fiscal 2010. The State could even support a 2-cent reduction in fiscal 2007, without appropriating general funds into the ABF. However, even a 1-cent is projected to require some general fund support ($68 million) over the forecast period. Reducing the State property tax rate back to the fiscal 2003 level of $0.084 per $100 of assessable base is projected to require $1.1 billion in general fund appropriations. **Appendices 4** and **5** show homeowner savings if State property taxes are reduced 1 cent or back down to the fiscal 2003 level.

Exhibit 7.3
Annuity Bond Fund
General Fund Subsidy Required to Fund State Property Tax Rate Reductions
($ in Millions)

State Property Tax Rate	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Total
No State Property Tax Rate Reduction ($0.132 per $100 of Assessable Base)	$0	$0	$0	$0	$0	$0
1-cent Reduction	0	0	0	17	51	68
2-cent Reduction	0	18	112	108	115	353
3-cent Reduction	2	122	167	169	177	637
Reduce to Fiscal 2003 Level ($0.084 per $100 of Assessable Base)	91	222	269	276	290	1,148

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

2005 Bond Sales Demonstrate that Taxable Debt Increases Borrowing Costs

The State's capital program supports a number of different public policy objectives such as health, environmental, public safety, education, housing, and economic development objectives. Federal government regulations allow the State to issue debt that does not require the buyer to pay federal taxes on interest earnings. In cases where investors do not pay federal income taxes, they are willing to settle for lower returns. Conversely, investors in taxable debt require higher returns to offset their tax liabilities. Consequently, the State can offer lower interest rates on tax-exempt bonds. Data from 2005 taxable bond sales allow the Department of Legislative Services (DLS) to quantify the additional costs associated with taxable bond issuances.

Federal laws and regulations limit the kinds of activities the proceeds from tax-exempt bonds can support. One such requirement limits private activities or private use of the bond proceeds to 5 percent of the bond sales proceeds or $10 million per bond sale. Examples of programs that support private activities or uses include the Rental Housing and Homeownership programs of the Department of Housing and Community Development, Camden Station – Babe Ruth Museum of the Stadium Authority, Hazardous Substance Cleanup Program of the Department of the Environment, and One Maryland Fund of the Department of Business and Economic Development.

Elimination of Operating Appropriations Results in Taxable Bond Issuances in 2005

To avoid exceeding the private activity limits imposed in the federal regulations, the State has previously appropriated funds in the operating budget instead of issuing debt for private activity programs and projects. Recent years' fiscal constraints have limited the amount of operating funds available for capital projects. To continue these programs, the State authorized GO bonds. Since fiscal 2004, the State has essentially migrated private use programs from the operating budget into the capital budget. The Department of Budget and Management's (DBM) Fiscal 2006 Capital Budget estimates that the State will issue $35 million annually in private activity bonds through fiscal 2010.

Through 2004, the State exclusively sold tax-exempt bonds. In 2005, the State reached its limit with respect to private activity exemptions in tax-exempt issuances, and the State was forced to sell taxable debt. These sales provide data from actual bond sales that can be used to test the hypothesis that taxable debt is more expensive than tax-exempt debt.

Hypothesis: Taxable Debt Is More Expensive Than Tax-exempt Debt

Because the holders of tax-exempt bonds do not pay federal taxes on interest earnings, the interest rates of tax exempt bonds tend to be less than taxable bonds. In theory, this should reduce the State's borrowing costs and debt service payments. Based on data provided by the State's financial advisor (Public Resources Advisory Group), DLS estimated that taxable debt's interest rate would exceed tax-exempt debt's interest rates by more than 100 basis points (for example, increasing the interest rate from 4.00 to 5.00 percent).

Analysis of March 2005 Bond Sale: Over $500,000 in Additional Costs

At the time of the March 2005 bond sale there was considerable demand for Maryland's taxable debt. The State issued $25 million of taxable debt which was bid on by 18 underwriters. The debt's True Interest Cost (TIC) was 3.87 percent. (By contrast, the tax-exempt issuance generated five bids.)

The debt was structured differently than traditional bond sales. When issuing tax-exempt debt, the State issues a series of bonds with maturities ranging from 3 to 15 years. The average maturity is usually just under 10 years. The taxable bonds' maturities range from 1 to 3 years, with annual debt service payments just under $9 million.

Comparing the costs of this first taxable bond sale with the costs of a tax-exempt bond sale is fairly straightforward. Using interest rate data received from Raymond James & Associates, Inc., a financial services firm, DLS was able to estimate the costs of a similarly structured tax-exempt issuance and compare those costs with the costs of the taxable issuance. **Exhibit 7.4** shows that issuing taxable debt (rather than tax-exempt debt) increased debt service payments by an estimated $531,000 from fiscal 2006 to 2008. Using the interest rates provided by Raymond James, a similar tax-exempt bond issuance yields a TIC of 2.62 percent, which are 125 basis points (1.25 percent) less than the taxable bonds' TIC.

Exhibit 7.4
March 2005 Taxable Bond Sale
Taxable Debt Costs Compared to Estimated Cost of Similar Tax-exempt Debt
($ in Thousands)

Fiscal Year	Taxable Debt Service	Tax-exempt Debt Service	Additional Cost for Taxable Debt
2006	$8,952	$8,740	$212
2007	8,954	8,745	210
2008	8,949	8,840	109
Total	**$26,855**	**$26,325**	**$531**

Sources: Public Resources Advisory Group and Raymond James Municipal Market Snapshots

Analysis of July 2005 Bond Sale: Over $1 Million in Additional Costs

In July 2005, the State had its second taxable bond sale. As with the March taxable bond sale, there was significant interest in the July bond sale. In the July bond sale, the State issued $20 million of taxable debt. There were 14 bidders, and the debt's TIC was 4.43 percent.

The July issuance was structured differently than the March issuance, and the analysis is more complicated. The March issuance began retiring debt after one year and retired all debt within three years. As with tax-exempt issuances, the taxable debt issued in July only pays interest in the first two years and does not begin retiring debt until the third year. This issuance retires all taxable debt within seven years of issuance.

The July issuance was also unique because it did not sell at a substantial premium. Instead, the winning bid offered lower interest rates and a rather marginal premium totaling approximately $36,000. By contrast, the tax-exempt issuance offered a high premium and higher coupon rate with greater debt service costs.

In the July bond sale, taxable debt actually reduced out-year debt service costs by offering an interest rate lower than the interest paid on tax-exempt debt. Taxable debt interest rates range between 4.25 and 4.50 percent. By contrast, tax-exempt debt's interest rate is a constant 5.00 percent through fiscal 2012. The lower rates paid with taxable debt reduced interest payments by approximately $600,000.

However, these savings are offset by a reduced bond sale premium. The TIC for GO bonds maturing by 2012 is 3.12 percent. This is 131 basis points (1.31 percent) below the TIC for taxable debt. DLS estimates that, had the taxable debt's TIC been 3.12 percent (instead of 4.43 percent), the taxable debt would have generated a premium totaling approximately $1.7 million.

In sum, the taxable debt issued at this bond sale increased State expenditures by approximately $1.1 million. This is the result of a reduced premium totaling $1.7 million, offset by $600,000 in reduced borrowing costs for taxable debt.

Recommendation to Reduce Costs Moving Taxable Debt Programs and Projects Back into Operating Budget PAYGO Program

Although both taxable issuances were structured differently resulting in different costs and premiums, both taxable issuances were more expensive than similarly structured tax-exempt issuances. The two taxable bond sales show that issuing taxable debt increases State costs. In sum, the State's issuance of $45 million in taxable debt cost $1.6 million more than issuing tax-exempt debt.

State policy has been to fund capital programs and projects that do not qualify as tax-exempt bonds with general funds. This policy has been shown to reduce borrowing costs. In times of fiscal stress, the amount of general funds appropriated for capital programs and projects has been reduced.

As a by-product of the most recent fiscal downturn, the State has issued taxable debt and the State has incurred higher borrowing costs. In the past, general fund appropriations have been restored to the capital program when the State's finances improved.

To reduce borrowing costs and provide for a more efficient capital program, it is recommended that the Administration appropriate general funds for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds.

Current SAC policy is to include revolving loan fund capital programs receiving general funds in the SAC spending limit. The committee is concerned that this could create a disincentive to move funding for these capital programs back into the general fund. **To eliminate a potential disincentive to restore general fund appropriations for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds, it is recommended that SAC exclude PAYGO capital general fund appropriations made in the 2006 legislative session from the affordability calculation. This exclusion should be limited to projects previously funded with taxable GO bonds that are funded with general funds instead.**

Public School Construction Spending Goal: Progress Made but the Goal Is Still Not Met

Chapter 307, Acts of 2004, also referred to as the Public School Facilities Act of 2004, established a State goal to fully fund school construction projects by fiscal 2013 to meet all minimum required standards as of July 2003. The Act was a response to the November 2003 survey results of the Task Force to Study Public School Facilities, chaired by State Treasurer Nancy K. Kopp. The task force concluded that many Maryland public schools were deficient in some capacity and that the cost to bring schools up to standard would be $3.85 billion. Through the Public School Facilities Act, the State would provide $2 billion of the $3.85 billion over the next eight fiscal years, with the remaining balance funded by local governments. In 2004 the State had committed to $800 million ($100 million annually) in DBM's *Capital Improvement Program* (CIP), leaving a $1.2 billion shortfall. Increasing the authorization by $150 million annually ($250 million total) for eight years would allow the State to meet the goal.

CDAC is required by Chapters 306 and 307 to review school construction needs and make a funding recommendation annually. In 2004 the committee recommended to the General Assembly that the State continue to authorize $100 million in public school construction and also analyzed the effect of authorizing an additional $1.2 billion for public school construction. The committee concluded that authorizing this additional debt would not exceed debt capacity as currently defined, yet the committee warned that such a task would limit the State's ability to issue debt for other programs along with a caution that changes in personal income could breach affordability measures. The committee recommended that alternative funding mechanisms, new revenue streams, or shifting other capital projects be fully explored before considering an additional $1.2 billion in GO bond authorizations.

CDAC Does Not Make Specific Recommendation for School Construction

The legislation enacting the spending goal required that CDAC make specific recommendations concerning public school construction. CDAC noted that the General Assembly achieved the $250 million goal in fiscal 2006 without increasing the total debt authorized. CDAC also noted that the General Assembly used a combination of alternatives to achieve the goal. In its 2005 report, CDAC did not recommend an amount for school construction as it is required by law to do, nor did the committee provide any specific recommendations on how to achieve an annual school construction funding level. The closest the committee came to a recommendation regarding school construction is:

"Clearly, relying solely on capital debt is neither sufficient nor necessary. The Committee's proposed out-year authorization estimates, including a 3% increase per year and no drop in authorizations in 2009, as had been projected in the past, provides additional debt capacity."[2]

The committee also reviewed the following alternatives it suggested last year.

- ***Alternative Financing Sources:*** Chapters 306 and 307, Acts of 2004 authorize the use of alternative financing methods, such as leasing arrangements with contractors, and allows all counties to issue bonds for public school construction. The law required the regulations pertaining to these new laws to be promulgated by July 2005. This has not yet occurred. The Interagency Committee on School Construction (IAC) advises that the regulations are still being developed and should be implemented by the end of fiscal 2006. The IAC has noted that anecdotal evidence suggests that school systems are not pursuing alternative financing methods as they are more expensive than issuing tax-exempt debt over the long-term.

- ***New Revenues:*** Possible revenue sources include enacting legislation allowing video lottery terminals and increasing State property tax rates, or dedicating current revenues.

- ***Shifting Funds From Other Projects:*** As noted in Appendix 1, the current capital requests exceed available funding. Each year DBM prepares a five-year CIP, which identifies capital projects to be funded. The CIP funding levels are generally consistent with CDAC's proposed authorizations. (One minor difference, for example, is that the program is slightly less than that CDAC's proposed authorizations to provide funds for legislative initiatives.) To provide additional funding for public school construction would require the State to delay or eliminate other projects in CIP. Possible capital program reductions include stopping construction projects that are underway, delaying construction projects not yet begun, reducing grant projects, and reducing legislative initiatives. DLS will again examine the implications of reducing the current capital program to fund more public school construction

[2] 2005 CDAC Report, p. 46.

when the Governor's capital budget is submitted at the beginning of the 2006 legislative session.

$3.85 Billion Does Not Buy What It Used To

A survey of public school facilities was conducted in 2003 for the Task Force to Study Public School Facilities. The statewide figure of $3.85 billion in facility needs was based on July 2004 dollars (for projects funded in fiscal 2005). As with other capital projects in the State, building costs have gone up significantly in the last few years. The Building Construction Index, an estimate of construction inflation, estimates that costs will increase 7.9 percent in 2005. In response to rising construction costs, the Public School Construction Program (PSCP) has increased the allowable cost per square foot for building from $140.00 for fiscal 2005 to $190.00 for fiscal 2007, a massive 35.5 percent increase over the period.

The PSCP staff is concerned that the fiscal 2007 cost allowance is still too low. They note that anecdotal evidence suggests that actual bids are running higher than the allowance and point to Hurricanes Katrina and Rita, and the September gas price spike as the primary causes for the higher prices. The PSCP will collect some comparative data and may recommend that the IAC consider increasing the fiscal 2007 allowable cost per square foot. The concern about the increasing costs is that the authorized bonds will fund less, more expensive projects.

Given all price uncertainty in the construction market, developing an accurate estimate of needs may be difficult. Factors influencing construction prices are varied. Some factors, such as increased materials prices, appear likely to be sustained over a period of years. Other factors, such as the effect of Hurricanes Katrina and Rita, may have a more short-term effect on prices. The legislation enacting the public school construction spending goal requires that needs be reassessed periodically. In 2007 the PSCP will again collect project specific data and that should provide a clearer indication of construction needs. This may be an ideal time to reassess the State's spending commitment. By this time the construction market may have settled, and it may be easier to prepare a careful, comprehensive estimate.

Spending Goal Met in 2005 Legislative Session

The 2005 CIP provided $157.4 million for school construction in fiscal 2006 only, returning to the $100 million annual level in the out-years. During the 2005 legislative session, the General Assembly increased the amount to $250 million in fiscal 2006. The General Assembly used several alternatives to achieve the goal, primarily increasing GO bond authorizations for school construction by $79.2 million, which involved both reducing and delaying funds for some capital projects in order to remain within the CDAC's recommended debt limit. Unspent school construction funds from prior years available in the contingency fund provided $15 million and shifting $45.2 million in bond-funded programs to the operating budget as PAYGO, in some cases avoiding the need to issue taxable debt, brought the total to $250 million for school construction projects.

CDAC and the General Assembly Have Made Substantial, Though Incomplete, Efforts to Expand Public School Construction Authorizations

The State goal is to authorize $2 billion from the 2005 through 2012 sessions. This averages to $250 million per session. In 2005 the General Assembly was able to provide additional funds so that the goal was met. The Administration is proposing to authorize $150 million in the 2006 session, and the January 2005 CIP proposes authorizing $100 million annually in the out-years. This provides $1 billion in authorizations between the 2005 and 2012 sessions.

In September 2005, CDAC proposed increasing authorizations. (Details concerning this increase are provided in Chapter 3.) **Exhibit 7.5** shows that the new authorization policy increases GO bond authorizations by $550 million through the 2012 session. This could support in the State spending goal. Nonetheless, even if the State applies the entire amount to the public school construction program, the State is still $450 million short of the $2 billion goal.

Exhibit 7.5
Capital Debt Affordability Committee's
Recommended Levels of General Obligation Bond Authorizations
($ in Millions)

Session	2004 Proposed GO Bond Authorizations	Additional CDAC Proposed Authorizations	Total Proposed Authorization
2006	$685	$5	$690
2007	700	10	710
2008	715	15	730
2009	630	115	745
2010	645	125	770
2011	660	135	795
2012	675	145	820
Total	**$4,710**	**$ 550**	**$5,260**

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations for Fiscal 2007*, September 2005

Additional Debt for Public School Construction Is Affordable, Restrictive, and Expensive

Based on the most recent personal income and revenue projections, issuing additional GO bond debt for public school construction is affordable. As noted in the previous section, the State has earmarked $1 billion for public school construction from fiscal 2006 to 2013. CDAC modified policies to provide an additional $550 million in additional authorizations. Depending on how much of this $550 million will support school construction, the State still has a funding gap ranging between $450 million and $1 billion.

Exhibit 5.7, earlier shown in this report, shows that DLS estimates that unused debt capacity (based on debt issued) totals $792 million through the fiscal 2007 to 2011 forecast period. Insofar as at least $208 million of the increased authorizations are used to support public school construction, there is sufficient capacity issue additional debt to support full funding of the State's public school construction spending goal.

However, fully funding public school construction with GO bonds raises two issues. The first issue is that this could potentially exhaust unused capacity. Exhausting unused capacity to expand public school construction could leave little flexibility if personal income growth does not meet expectations. This also limits the use of debt for other priorities that may arise.

A second issue is that this increases borrowing costs. Even under the most conservative approach, where the State dedicates all of the additional $550 million in capacity for public school construction, the State would need to sell $450 million in GO bonds, resulting in an additional $241 million in debt service costs over the life of the bonds and an annual debt service payment totaling $49.4 million. If the State were to exhaust its capacity to support public school construction and issue an additional $792 million, additional debt service costs would total $424 million and annual debt service costs would be $86.9 million.

Another Option – PAYGO

Although not specifically recommended by CDAC, one of the alternatives used by the General Assembly to reach $250 million in fiscal 2006 was the use of available cash (i.e., PAYGO) for certain capital programs and projects. The General Assembly restricted $45.2 million in available funds in the State Reserve Fund for certain programs and projects, freeing up an equivalent amount of GO bonds for school construction.

Earlier in this chapter, DLS recommends moving revolving loan programs, currently supported by taxable debt, back into the PAYGO program. In addition to the efficiency realized, this recommendation also provides for additional GO capacity that can be applied to the public school construction program. Using PAYGO allows the State to ramp-up the public school construction program more quickly. Insofar as CDAC's increased authorizations are more modest in the early years, PAYGO complements the CDAC approach quite well. PAYGO also has the added benefit of providing the State with more flexibility to reimburse local education agencies for projects that were forward funded by county governments in prior years.

Appendix 1

Capital Budget Requests for Fiscal 2007 to 2011

Agency requests for fiscal 2007 total $957.3 million, over $267.3 million more than the amount available under the recommended GO bond debt limit of $690 million. Capital requests for the next five years total nearly $5.2 billion, while the projected debt limit for the same period totals about $3.6 billion. These figures demonstrate that the number of capital projects proposed far exceeds the ability of the State to appropriate bond funds to provide for capital needs. The table below provides a listing of GO bond capital requests over the next five years. This listing reflects agency requests and will differ from the list that will appear in the Governor's fiscal 2007 *5-Year Capital Improvement Plan*.

GO Bond Requests: Fiscal 2007 – 2011
($ in Millions)

	Fiscal Years						Category
	2007	**2008**	**2009**	**2010**	**2011**	**Total**	**Totals**
State Facilities							$560.0
Board of Public Works	$104.8	$53.7	$60.4	$122.0	$204.8	$545.7	
Military	0.0	2.7	0.9	2.7	0.0	6.3	
Dept. Disabilities/Veterans Affairs	1.6	1.6	1.6	1.6	1.6	8.0	
Health and Social Services							$365.0
Health and Mental Hygiene	$14.3	$50.1	$22.5	$21.9	$104.4	$213.2	
University of MD Medical System	5.0	10.0	12.5	10.0	10.0	47.5	
Senior Citizen Activity Center	1.5	1.5	1.5	1.5	1.5	7.5	
Juvenile Justice	5.7	7.9	47.7	7.5	4.5	73.3	
Private Hospital Grant Program	3.5	5.0	5.0	5.0	5.0	23.5	
Environment							$312.0
Natural Resources	$13.0	$13.0	$13.0	$13.0	$10.0	$62.0	
Agriculture*	4.6	7.3	7.5	8.0	8.5	35.9	
Environment	37.5	39.1	39.3	39.3	37.8	193.0	
MD Environmental Service	2.9	4.1	3.8	5.5	4.8	21.1	
Education							$1,318.8
Education	$0.0	$0.8	$50.5	$0.0	$0.0	$51.3	
MD School for the Deaf	22.6	4.9	0.3	1.1	1.0	29.9	
Public School Construction**	247.6	247.4	247.6	247.4	247.6	1,237.6	
Higher Education							$1,623.4
University System of MD***	$151.6	$168.5	$110.8	$222.5	$211.6	$865.0	
Baltimore City Comm. College	0.0	26.2	1.7	1.2.3	14.9	42.8	
St. Mary’s College	9.2	0.8	21.9	3.7	0.0	35.6	
Morgan State University	15.9	12.7	39.5	5.2	32.6	105.9	
Community Colleges	75.6	154.6	112.4	95.5	83.9	522.0	
Southern MD Higher Educ. Center	0.0	0.0	0.0	0.8	10.3	11.1	
Private Facilities Grant Program	9.0	8.0	8.0	8.0	8.0	41.0	
Public Safety							$523.7
Public Safety	$89.7	$79.3	$59.4	$60.7	$109.4	$398.5	
State Police	11.0	13.6	6.7	0.3	9.1	40.7	
Local Jails	7.5	15.0	48.8	9.4	3.8	84.5	
Housing and Economic Development							$251.0
Economic Development	$20.0	$20.0	$20.0	$20.0	$20.0	$100.0	
Housing and Comm. Development	26.2	25.8	24.9	24.3	27.3	128.5	
Canal Place	0.0	2.5	0.0	0.0	0.0	2.5	
Historic St. Mary’s City	1.2	1.3	6.1	0.7	1.0	10.3	
Planning	0.3	3.0	0.3	2.3	3.8	9.7	
Legislative Initiatives	15.0	15.0	15.0	15.0	15.0	75.0	$75.0
Miscellaneous	56.5	53.3	28.0	29.5	7.5	174.8	$174.8
Subtotal Request	**$953.3**	**$1,048.7**	**$1,017.6**	**$984.4**	**$1,199.7**	**$5,203.7**	**$5,203.7**
Tobacco Transition Program	4.0	4.0	3.5	3.5	0.0	15.0	$15.0
Total Request	**$957.3**	**$1,052.7**	**$1,021.1**	**$987.9**	**$1,199.7**	**$5,218.7**	**$5,218.7**
Debt Affordability Limits	**$690.0**	**$710.0**	**$730.0**	**$745.0**	**$770.0**	**$3,645.0**	

*The Department of Agriculture request does not include the Tobacco Transition Program.

**The Interagency Committee on School Construction received requests in excess of $470 million for fiscal 2007; however, the amount included in the request to the Department of Budget and Management only reflects level funding with fiscal 2006 authorization.

***In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding of $25.0 million annually for fiscal 2006 – 2010.

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

Source: Department of Budget and Management

Estimated General Obligation Issuances
($ in Thousands)

Legislative Session	Proposed Authorizations (a)	Estimated Issuances during Fiscal Year (b) ====> 2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total Issued
2006	$690,000	$0	$213,900	$172,500	$138,000	$103,500	$62,100					$690,000
2007	710,000		0	220,100	177,500	142,000	106,500	$63,900				710,000
2008	730,000			0	226,300	182,500	146,000	109,500	$65,700			730,000
2009	745,000				0	230,950	186,250	149,000	111,750	$67,050		745,000
2010	770,000					0	238,700	192,500	154,000	115,500	$69,300	770,000
2011	795,000						0	246,450	198,750	159,000	119,250	795,000
2012	820,000							0	254,200	205,000	164,000	820,000
2013	845,000								0	261,950	211,250	845,000
2014	870,000									0	269,700	870,000
2015	895,000										0	895,000
Total New Authorization		0	213,900	392,600	541,800	658,950	739,550	761,350	784,400	808,500	833,500	
Previously Authorized GO Bonds:	1,826,124	750,000	461,100	307,400	183,200	66,050	10,450	13,650	15,600	16,500	1,500	1,825,450
Total Issuances:		**$750,000**	**$675,000**	**$700,000**	**$725,000**	**$725,000**	**$750,000**	**$775,000**	**$800,000**	**$825,000**	**$835,000**	

Notes:

(a) It is assumed that authorizations increase 3% annually.

(b) Percentage issuance assumptions by fiscal year:

	1st	2nd	3rd	4th	5th
Fiscal year following year of authorization	1st	2nd	3rd	4th	5th
Percent of authorization issued	31.0%	25.0%	20.0%	15.0%	9.0%

Debt Outstanding
($ in Millions)

	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05	FY 95-05
Agency Debt Subject to Ceiling and Allocation Caps												
MD Environmental Service	$29.9	$34.8	$33.7	$31.0	$34.0	$29.4	$34.4	$36.5	$33.7	$30.5	$30.5	2%
MD Wholesale Food Ctr. Auth.	7.2	7.2	7.1	7.0	6.9	6.8	6.7	0.0	0.0	0.0	0.0	-100%
MD Trans Authority	465.2	408.4	391.9	374.9	344.5	318.7	300.6	668.8	575.6	627.2	763.6	64%
MD Water Qual. Finan. Adm.	163.2	163.4	157.8	151.3	138.1	131.3	124.3	115.9	105.6	96.6	88.2	-46%
Revenue Cap Total	**$665.5**	**$613.8**	**$590.5**	**$564.2**	**$523.5**	**$486.2**	**$466.0**	**$821.2**	**$714.9**	**$754.3**	**$882.2**	**33%**
% Change/Prior Year	42%	-8%	-4%	-4%	-7%	-7%	-4%	76%	-13%	6%	17%	
Agency Debt Not Subject to Ceiling and Allocation Caps												
Balt. City Comm. College	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	n/a
DHCD (a)	2,446.5	2,340.8	2,304.5	2,387.1	2,473.5	2,627.0	2,692.1	2,705.8	2,672.8	2,415.1	2,194.6	-10%
Local Govt. Infra. (CDA)	48.5	55.0	62.5	66.1	81.1	85.5	87.7	91.7	105.6	114.6	122.5	153%
MD Energy Finance Admin.	202.6	300.9	307.4	306.2	301.1	388.4	379.8	0.0	0.0	0.0	0.0	-100%
MD Industrial Dev. Fin. Authority (b)	n/a	n/a	386.3	360.4	346.3	330.0	311.6	581.4	568.4	411.1	395.0	n/a
MDOT – County Revenue Bonds	n/a	n/a	n/a	45.5	34.6	25.6	19.0	12.9	7.9	4.5	31.8	n/a
MDOT – Non-tax-supported COPs	n/a	n/a	n/a	n/a	42.8	42.5	74.3	65.2	57.7	54.0	49.7	n/a
Morgan State University	28.9	29.4	29.9	27.9	27.5	27.1	26.8	33.4	72.2	70.0	68.6	137%
St. Mary's College	8.5	8.1	7.8	17.5	17.3	16.9	27.8	27.5	40.6	39.7	40.6	377%
University System of Maryland	518.3	505.9	534.5	611.0	670.0	656.1	802.7	797.0	960.0	973.0	1,012.8	95%
Non-cap Total	**$3,253.3**	**$3,240.1**	**$3,632.9**	**$3,821.7**	**$3,994.2**	**$4,199.2**	**$4,421.7**	**$4,315.0**	**$4,485.1**	**$4,081.9**	**$3,915.4**	**20%**
% Change/Prior Year	6%	0%	12%	5%	5%	5%	5%	-2%	4%	-9%	-4%	

	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05	FY 95-05
Tax-supported Debt												
Transportation Debt	1,047.5	977.6	939.4	844.0	749.1	724.8	648.1	714.2	961.2	1,185.7	1,069.9	2%
Capital Leases – BPW	125.2	115.8	98.4	90.3	149.2	148.4	197.7	245.7	217.1	191.9	175.1	40%
General Obligation Debt	2,619.1	2,859.9	3.025.4	3,270.5	3,500.2	3,348.9	3,450.9	3,544.2	3,932.5	4,102.3	4,511.8	72%
Tax-supported Debt Total	**3,791.8**	**3,953.3**	**1,037.8**	**4,204.8**	**4,398.5**	**4,222.1**	**4,296.7**	**4,504.1**	**5,110.8**	**5,479.8**	**5,756.8**	**52%**
% Change/Prior Year	3%	4%	-74%	305%	5%	-4%	2%	5%	13%	7%	5%	
Authorities and Corporations Not Subject to Ceiling and Allocation Caps												
Health/Higher Ed. Facilities Authority	2,256.6	2,348.4	2,489.7	2,821.0	3,236.6	3,555.0	3,660.8	4,265.4	4,619.5	5,316.9	5,544.3	146%
MD Economic Development Corp.	61.0	141.0	177.0	227.7	321.1	635.4	855.6	1,077.7	1,483.9	1,591.9	1,667.8	2634%
Auth. and Corp. Total	**2,317.6**	**2,489.4**	**2,666.7**	**3,048.7**	**3,557.7**	**4,190.4**	**4,516.4**	**5,343.1**	**6,103.4**	**6,908.8**	**7,212.2**	**211%**
% Change/Prior Year	0%	4%	6%	13%	15%	10%	3%	17%	8%	15%	4%	

(a) Excludes local government infrastructure.

(b) Balances have been restated to reflect the inclusion of the Maryland Industrial Development Financing Authority's Economic Development Revenue Bonds (Holy Cross Health System Corporation) Series 1993.

Source: Department of Budget and Management

Appendix 4

Annual State Property Tax Savings for Homeowners
Effect of Reducing Property Tax Rate 1 Cent
$0.122 per $100 of Assessable Base

Home Value	Current Tax Bill	1-cent Reduction	Savings
$100,000	$132	$122	$10
200,000	264	244	20
300,000	396	366	30
400,000	528	488	40
500,000	660	610	50
600,000	792	732	60
700,000	924	854	70
800,000	1,056	976	80
900,000	1,188	1,098	90
1,000,000	1,320	1,220	100
1,100,000	1,452	1,342	110
1,200,000	1,584	1,464	120
1,300,000	1,716	1,586	130
1,400,000	1,848	1,708	140
1,500,000	1,980	1,830	150
1,600,000	2,112	1,952	160
1,700,000	2,244	2,074	170
1,800,000	2,376	2,196	180
1,900,000	2,508	2,318	190
2,000,000	2,640	2,440	200
2,100,000	2,772	2,562	210
2,200,000	2,904	2,684	220
2,300,000	3,036	2,806	230
2,400,000	3,168	2,928	240
2,500,000	3,300	3,050	250
2,600,000	3,432	3,172	260
2,700,000	3,564	3,294	270
2,800,000	3,696	3,416	280
2,900,000	3,828	3,538	290
3,000,000	3,960	3,660	300

Source: Department of Legislative Services, February 2005

Appendix 5

Annual State Property Tax Savings for Homeowners
Effect of Reducing Property Tax Rate to Fiscal 2003 Level
$0.084 per $100 of Assessable Base

Home Value	Current Tax Bill	4.8-cent Reduction	Savings
$100,000	$132	$84	$48
200,000	264	168	96
300,000	396	252	144
400,000	528	336	192
500,000	660	420	240
600,000	792	504	288
700,000	924	588	336
800,000	1,056	672	384
900,000	1,188	756	432
1,000,000	1,320	840	480
1,100,000	1,452	924	528
1,200,000	1,584	1,008	576
1,300,000	1,716	1,092	624
1,400,000	1,848	1,176	672
1,500,000	1,980	1,260	720
1,600,000	2,112	1,344	768
1,700,000	2,244	1,428	816
1,800,000	2,376	1,512	864
1,900,000	2,508	1,596	912
2,000,000	2,640	1,680	960
2,100,000	2,772	1,764	1,008
2,200,000	2,904	1,848	1,056
2,300,000	3,036	1,932	1,104
2,400,000	3,168	2,016	1,152
2,500,000	3,300	2,100	1,200
2,600,000	3,432	2,184	1,248
2,700,000	3,564	2,268	1,296
2,800,000	3,696	2,352	1,344
2,900,000	3,828	2,436	1,392
3,000,000	3,960	2,520	1,440

Source: Department of Legislative Services, February 2005