Issue Papers

2005 Legislative Session

Presentation to the

Maryland General Assembly

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Office of Policy Analysis
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December 30, 2004

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2004.

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

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

Sincerely,

Karl S. Aro
Executive Director

KSA/mll

Contents

17. Local Government

Operating Budget

Economic and Revenue Outlook

The Maryland economy has experienced a marked acceleration in 2004, and the economic outlook is consequently a bit more positive than was forecast in December 2003. Revenue over-attainment in fiscal 2004 and stronger economic growth lead to an upward revision in the estimate for fiscal 2005 general fund revenues of $376 million.

Economic Outlook

The Maryland economy has begun to experience accelerating growth after three sluggish years. Although the recession that began in March 2001 and ended in November 2001 was relatively mild in Maryland, the State did go through three years with employment growth of less than 1 percent. In the last two years, 2002 and 2003, personal income growth was less than 4 percent. The economic situation turned decidedly more positive starting in early 2004. In the first nine months of 2004, Maryland employment is 1.4 percent higher than the same period in 2003, an increase of 34,600 jobs. By comparison, employment for all of 2003 grew by just 0.2 percent (5,200 jobs). Personal income growth has also accelerated. For the first half of 2004, personal income in Maryland is up almost 5.8 percent. Wage and salary income is also up almost 5.8 percent over the same period last year. In 2003 both total personal income and wage and salary income grew just 3.8 percent.

In light of the improving employment and personal income data, the economic outlook is somewhat better than the forecast from December 2003 that was the basis of the Board of Revenue Estimates revenue projections (**Exhibit 1**). At that time, the board was already anticipating that the Maryland economy would improve in 2004 and over the next several years. As a result, the employment outlook today is only slightly better than the board's forecast. In terms of personal income, the outlook is more significantly improved reflecting stronger wage and salary growth and better performance from business income from partnerships and sole proprietorships.

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

Calendar	Employment		Personal Income	
Year	**Dec. 2003**	**Sept. 2004**	**Dec. 2003**	**Sept. 2004**
2001	0.7%	0.7%	5.0%	5.1%
2002	0.2%	0.4%	3.8%	3.8%
2003	0.4%	0.2%	3.1%	3.8%
2004E	1.3%	1.5%	4.6%	5.6%
2005E	1.9%	2.1%	5.5%	5.7%
2006E	1.9%	2.0%	5.3%	5.9%
2007E	1.7%	1.8%	4.8%	5.5%

Source: December 2003 is from the Board of Revenue Estimates. September 2004 is from the Department of Legislative Services.

Revenue Outlook

The improving economy along with some other factors pushed general fund revenues in fiscal 2004 to $10.3 billion, exceeding the estimate for the year by $261 million. Total general fund revenues grew by 9.5 percent over fiscal 2003. There were a number of law changes from 2003 to 2004 that artificially boosted the increase, but adjusting for those factors still results in very strong growth of 7.3 percent between the two years. Combined, the major economic-related revenues sources, the personal income tax, the sales tax, and the corporate income tax, exceeded their estimates by $176 million. Other revenues sources that are not as directly tied to the economy, the lottery and estate and inheritance taxes, also did well, exceeding their estimates by $18 million and $21 million, respectively.

The Department of Legislative Services (DLS) estimates that in fiscal 2005, total general fund revenues will be about $376 million higher than currently expected and will grow about 6.5 percent over fiscal 2004 (**Exhibit 2**). These figures include almost $72 million from payments to settle back taxes relating to the use of Delaware holding companies. Senate Bill 187 (2004 session) established a settlement period that ran from July 1 to November 1, 2004, for corporations that pay taxes owed from the use of Delaware holding companies for tax years 1996 to 2003. At the time the DLS forecast was finalized in early October, the general fund had already received about $45 million from such payments. The current official estimate assumed just $8 million from the settlements. If this one-time revenue is excluded, the DLS estimate for fiscal 2005 is higher than the current estimate by $313 million and grows over fiscal 2004 by 5.9 percent. In fiscal 2006, DLS expects total general fund revenues to grow 3.8 percent over fiscal 2005 or 4.5 percent if the Delaware holding company settlement payments from fiscal 2005 are excluded.

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

	FY 2005				FY 2006	
	Current Official Estimate	DLS Sept. 2004	$ Diff.	% Change 2004/2005	DLS Sept. 2004	% Change 2005/2006
Personal Income Tax	$5,351	$5,388	$37	6.1%	$5,702	5.8%
Sales & Use Tax	2,971	3,104	133	6.2%	3,255	4.8%
Lottery	441	441	0	1.1%	458	3.7%
Other	1,779	1,984	205	9.1%	1,923	(3.1%)
Total	**$10,542**	**$10,918**	**$376**	**6.5%**	**$11,338**	**3.8%**

Source: Board of Revenue Estimates; Department of Legislative Services

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Operating Budget

Budget Outlook

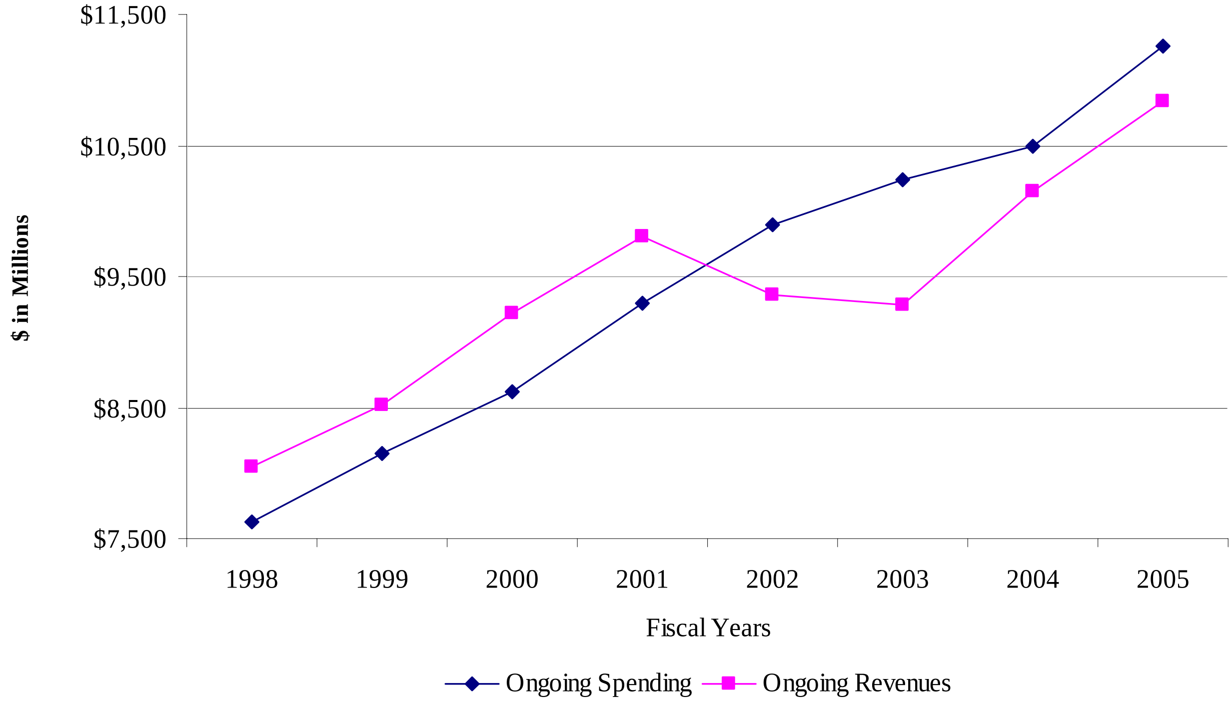
Structural budget shortfalls have transitioned from an acute to a chronic condition. Achieving a cure within the next five years will require more than normal budget restraint and a recovering economy can provide.

Where We Have Been

The effects of the economic downturn that officially began and ended in calendar 2001 have been well documented over the past several years. General fund revenues declined in fiscal 2002 and 2003, creating a gap, or structural deficit, between ongoing revenue and spending which the State has yet to close. The deficit has been, and continues to be, exacerbated by legislation enacted in 2002 that has resulted in phased increases in enhanced local education aid that will continue to grow through fiscal 2008. Ultimately, more than $1.3 billion in additional education aid will be provided to the local school systems, despite the lack of corresponding ongoing revenues to offset that spending. This is in addition to existing spending pressures due to Medicaid and other entitlement programs and the costs of maintaining existing spending commitments through the structure of State government agencies and personnel.

Initial efforts to address the shortfall began in fiscal 2002 with limited mid-year cost containment and use of one-time measures such as transfers and balances, based in part on the expectation of a rapid economic recovery. After the election of a new governor in 2002, there was continued reliance on one-time and short-term revenues and measures. Over the last two sessions, the debate has centered upon unsuccessful proposals to enhance revenues via the introduction of video lottery terminals. Governor Robert L. Ehrlich, Jr.'s unwillingness to consider other major tax enhancements has served to limit debate of other long-term revenue options. Thus, roughly $4.7 billion in one-time and short-term actions have been adopted over the fiscal 2002–2005 period to finance the operations of State government. By fiscal 2004, better than estimated general fund attainments reduced the structural gap to $337 million. The cash balance was also aided by one-time federal assistance to all states in fiscal 2003 and 2004, and more recently by one-time corporate tax amnesty in fiscal 2005 that was provided to corporations utilizing certain tax avoidance mechanisms such as Delaware Holding Companies. In sum, through fiscal 2005 the budget remains balanced on a cash basis but continues to harbor a deficit between operating spending and ongoing revenues in the range of about 4 percent of revenues. **Exhibit 1** illustrates the structural gap between revenues and spending over this period.

Exhibit 1
Ongoing Revenues Compared with Ongoing Spending
Fiscal 1998 – 2005

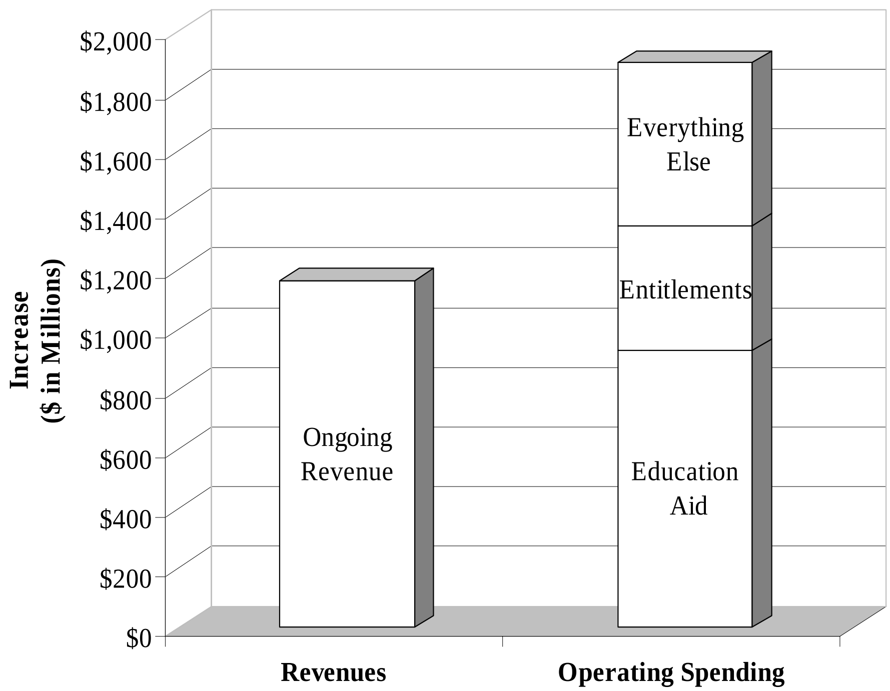


Source: Department of Legislative Services

Where We Are Going

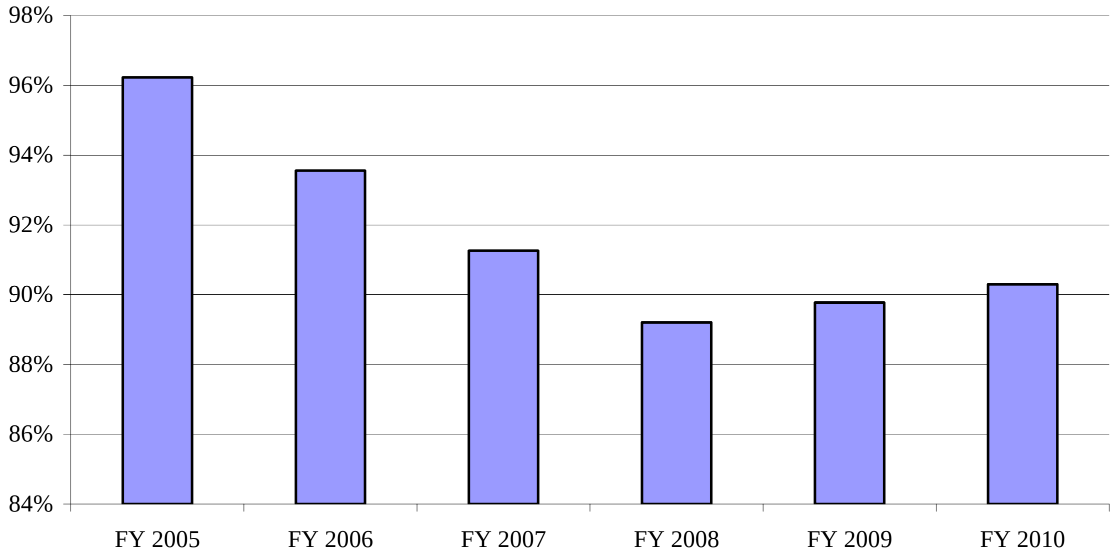
Over the coming years, the outlook for the budget remains virtually unchanged since the enactment of the Bridge to Excellence in Public Schools Act. Spending growth on education aid alone nearly consumes expected revenue growth for the period. When additional spending needs for entitlement programs, chiefly medical assistance payments, are factored into the equation, aid and entitlement programs outstrip projected revenues by nearly $200 million. **Exhibit 2** illustrates this disparity. Through fiscal 2008 when the Bridge to Excellence in Public Schools Act will be fully implemented, ongoing revenue as a percentage of spending falls from 96 cents in revenue received for every $1 spent in fiscal 2005 to about 89 cents for every dollar in fiscal 2008. **Exhibit 3** shows the trend in this revenue disparity. In other words, revenue growth over fiscal 2006–2008 is expected in the range of 5 percent annually while spending is expected to increase 7.5 percent annually. This results in deficits on both a cash and structural basis in the range of $1.1 billion in fiscal 2007, growing to $1.5 billion by fiscal 2008.

Exhibit 2
Projected Spending Outstrips Projected Revenue
Fiscal 2006 – 2008



Source: Department of Legislative Services

Exhibit 3
Ongoing Revenue Declines As a Percent of Ongoing Spending



Source: Department of Legislative Services

Exhibit 4 provides the revenue and spending outlook for the fiscal 2005–2010 period. One unknown variable relates to the outcome of the Administration's strategic budgeting process. In June 2004 State agencies were directed to critically evaluate their programs with the intent that each agency's fiscal 2006 budget request reflect a reduction of 12 percent compared with current spending levels. It may be expected that some level of reduction in general fund spending will be reflected in the budgets of many agencies, although the exact magnitude and the out-year impact of presumed changes cannot be reliably estimated. Reductions in agency spending will affect, and improve, the long-term budget outlook.

Exhibit 4
General Fund Projections
Fiscal 2005 – 2010

	Leg. Approp. FY 2005	Baseline FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	Annual Growth Rate FY 06-08	Avg. Annual Growth Rate FY 08-10
Revenues – October 2004 DLS Estimate								
Individual Income	$5,388	$5,702	$6,059	$6,449	$6,862	$7,305	6.3%	6.4%
Sales and Use	3,104	3,255	3,408	3,592	3,786	3,980	5.1%	5.3%
Lottery	441	458	470	482	496	511	2.7%	2.9%
Other	1,897	1,910	1,931	1,964	2,030	2,063	1.4%	2.5%
Subtotal	**$10,831**	**$11,325**	**$11,867**	**$12,487**	**$13,174**	**$13,860**	**5.0%**	**5.4%**
Adjustments								
Balance	$453	$560	$0	$0	$0	$0		
Short-term Revenues	166	13	0	0	0	0		
Rainy Day Fund Transfer	91	218	0	0	0	0		
BRFA of 2004 and Other Fund Transfers	384	0	0	0	0	0		
Total Revenues	**$11,924**	**$12,116**	**$11,867**	**$12,487**	**$13,174**	**$13,860**	**1.5%**	**5.4%**
Expenditures								
Debt Service	$0	$0	$0	$13	$63	$72	n/a	134.8%
Local Aid – Education\Libraries	3,683	4,165	4,592	5,092	5,249	5,417	10.6%	3.1%
Local Aid – Other	453	470	486	504	524	542	3.6%	3.6%
Entitlements	2,145	2,428	2,615	2,847	3,059	3,288	8.3%	7.5%
State Operations	4,807	5,077	5,346	5,576	5,814	6,065	4.8%	4.3%
Reversions	-36	-35	-35	-35	-35	-35	0.0%	0.0%
Deficiencies	205	0	0	0	0	0		
Subtotal	**$11,256**	**$12,105**	**$13,004**	**$13,998**	**$14,675**	**$15,349**	**7.5%**	**4.7%**
Capital	$1	$23	$33	$33	$2	$2	19.8%	-75.4%
Reserve Fund	107	300	8	10	10	9	-82.1%	-4.3%
Total Expenditures	**$11,364**	**$12,427**	**$13,044**	**$14,040**	**$14,687**	**$15,360**	**9.4%**	**4.6%**
Surplus (Shortfall)	**$560**	**-$311**	**-$1,177**	**-$1,553**	**-$1,513**	**-$1,500**		
Annual Change		-871	-866	-376	40	13		
Ongoing Revenues vs. Operating Expenses		**-$780**	**-$1,137**	**-$1,511**	**-$1,501**	**-$1,489**		
Revenue Stabilization Fund								
Ending Balance	$519	$567	$593	$624	$659	$693		
As a Percent of Revenues	4.8%	5.0%	5.0%	5.0%	5.0%	5.0%		
Ratio of Operating Revenues to Expenditures	0.96	0.94	0.91	0.89	0.90	0.90		

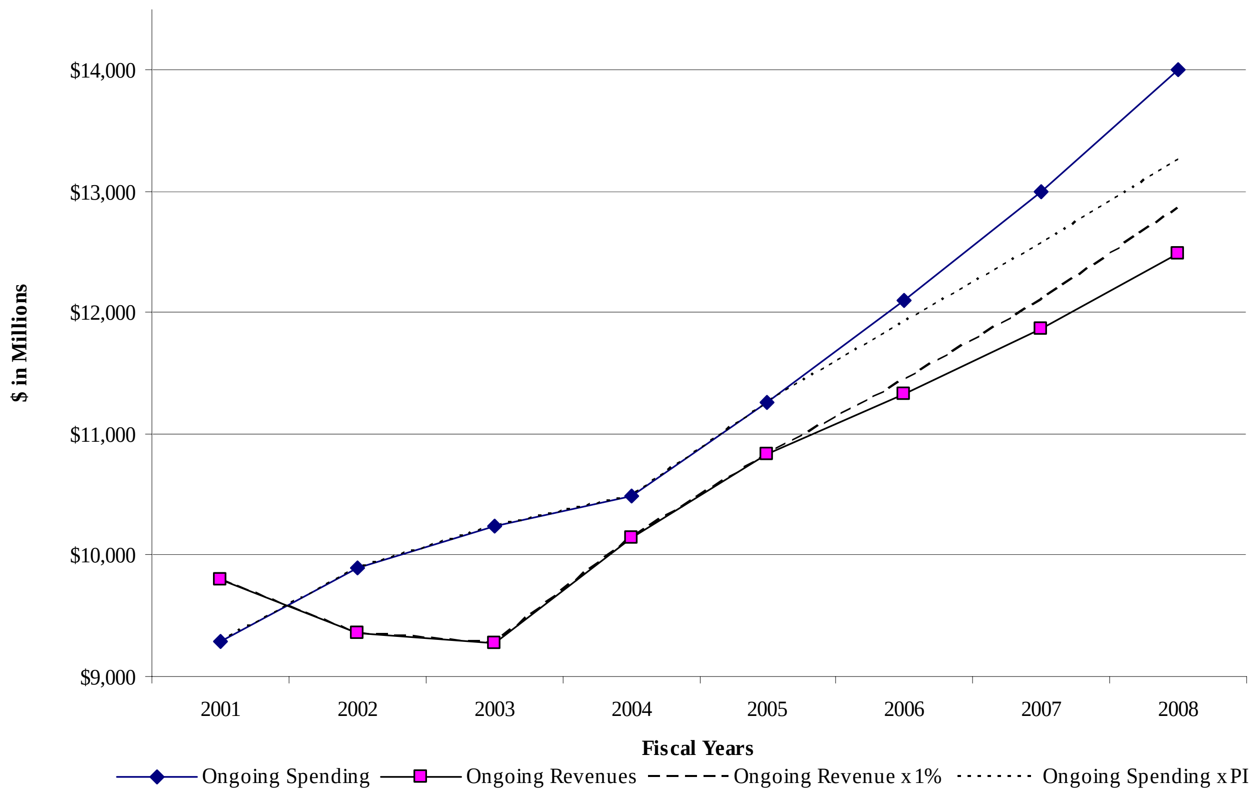
BRFA = Budget Reconciliation and Financing Act

Source: Department of Legislative Services

Inaction in Action

As shown in Exhibit 1, the structural gap was nearly erased by fiscal 2004 as job growth and economic recovery rejuvenated general fund revenue attainment beyond projected levels. Could better than expected revenue growth coupled with strategic spending reductions solve the structural deficit? **Exhibit 5** incorporates both assumptions into the ongoing revenue and spending trends currently projected by the Department of Legislative Services (DLS). Spending growth in this scenario, beginning in fiscal 2006, is limited to growth in personal income (ranging from 5.5 percent to a peak of 5.9 percent). Revenue growth is similarly increased by a compound rate of 1 percent annually. As illustrated by the dotted lines, even under these optimistic conditions a spending gap of about $200 million continues to persist.

Exhibit 5
The Structural Deficit Persists
Even Under Optimistic Revenue and Spending Assumptions



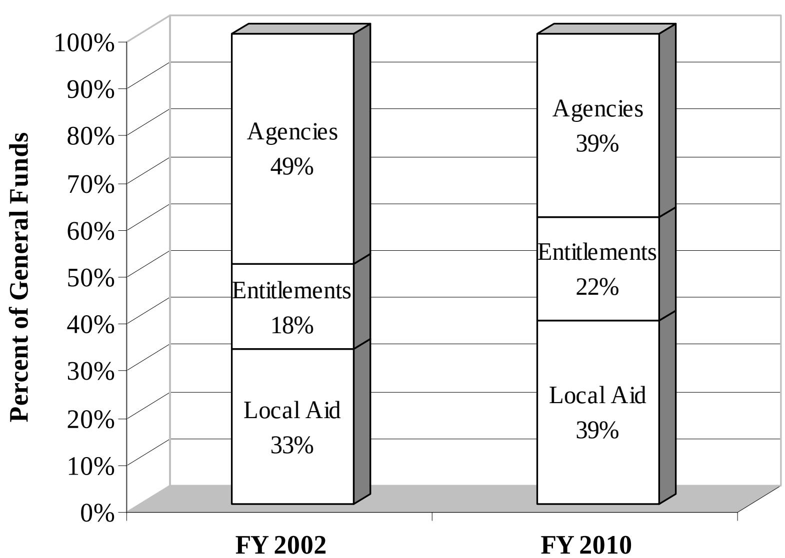
Source: Department of Legislative Services

Intergovernmental Consequences

Not surprisingly, increases in local aid have resulted in higher salary and compensation for local government employees and outpaced the compensation provided to State employees. DLS has previously reported that salaries for correctional officer positions in local detention centers are generally higher in counties where State prisons are operated, making recruitment and retention more difficult. To the extent local aid increases continue at levels contemplated through fiscal 2008, these disparities will widen. But these disparities portend a more intractable problem that will not be realized until the next economic downturn.

As **Exhibit 6** illustrates, the magnitude of local aid increases provided from fiscal 2002 to 2010 fundamentally alter the proportion of the general fund budget allocated to local aid and entitlement programs – areas that the Administration and legislature have found difficult to reduce during the current crisis. Spending on local aid will increase from 33 percent of the general fund budget to 39 percent and entitlement spending climbs from 18 to 22 percent. Combined, local aid and entitlement spending will increase from 51 to 61 percent of the total general fund budget. Should the next downturn similarly reduce general fund revenues by 5 percent in the first year, the resultant loss of nearly $700 million, if applied against only State agencies, would require a reduction of nearly 12 percent in agency spending.

Exhibit 6
Under Current Projections Local Aid and Entitlements Increase from 51 to 61 Percent of General Fund Spending for those Categories between Fiscal 2002 and 2010



Source: Department of Legislative Services

In conclusion, while the near-term outlook for the State remains optimistic on a cash basis the longer-term picture is less rosy. Economic recovery has boosted State revenues, but from a lower base than the State enjoyed a scant three fiscal years ago. The continued implementation of legislation to enhance education aid to local jurisdictions, in combination with entitlement and other spending pressures, results in a return of cash shortfalls and a structural deficit in the range of $1.0 to $1.5 billion in the latter half of the decade. The search for ongoing revenue has settled unsuccessfully on video lottery terminals over the past two legislative sessions, and other major tax proposals have been removed from consideration by the current administration. Efforts to strategically reduce agency spending and revenue actions contemplated during the 2005 legislative session may mitigate the situation. Absent structural reform of sufficient magnitude, State and local fiscal relationships are changing and could lead to more difficult decision making following the next economic downturn.

Operating Budget

Transportation Trust Fund

Revenues from vehicle registration fees are projected to increase by 75 percent from fiscal 2004 to 2005 due to Chapter 9 of 2004. This ongoing revenue, combined with moderate growth in the other major revenue sources, is expected to provide just over $5 billion in State funds for capital projects in the 2005 – 2010 period.

Fiscal 2004 Closeout

The Transportation Trust Fund (TTF) supports the activities of the Maryland Department of Transportation (MDOT). All taxes, fees, charges, and revenues collected or received by MDOT or any of its modal administrations or units are credited to the TTF, including the cash proceeds of the sale of bonds, any general funds appropriated to MDOT, and the proceeds of any federal grants received by MDOT. MDOT utilizes the funds from the TTF to fund its transportation projects and programs in accordance with annual appropriations.

The TTF closed fiscal 2004 with a special fund balance of approximately $288 million, which is $186 million above the estimated closing fund balance of $102 million. The higher than anticipated balance is due in large part to one-time cash receipts and/or to cash flow and therefore does not represent an ongoing increase in TTF revenues. Operating and capital expenditures were approximately $65 million lower than expected, due primarily to cash flow to ongoing capital projects, offset by bond sales that were $50 million lower than projected.

MDOT sold $320 million in new debt in consolidated transportation bonds in fiscal 2004, which raised total debt outstanding to $1.186 million at the end of the fiscal year; the sale generated a premium of $10 million in revenues for the TTF. MDOT also issued $75.9 million in refunding bonds to refund higher interest rate debt at the lower rates currently available.

Fiscal 2005 – 2010 TTF Forecast

Exhibit 1 shows the Department of Legislative Services' (DLS) fiscal 2005 through 2010 TTF forecast. The forecast details expected trends in revenue attainments, debt issuances, and capital expenditures.

Revenues from vehicle registrations are expected to increase by 75 percent in fiscal 2005 to $345 million from the actual fiscal 2004 attainment of $197 million; this reflects the increase in vehicle registration rates adopted during the 2004 legislative session (Chapter 9 of 2004). Revenues from all other sources are projected to show moderate growth. The TTF received $745 million in gas tax revenues in fiscal 2004; these revenues are expected to grow by nearly

Exhibit 1
Department of Legislative Services Transportation Trust Fund Forecast
Fiscal 2005 – 2010

	Base Year 2004	Current Year 2005	Estimate FY 2006	Estimate FY 2007	Estimate FY 2008	Estimate FY 2009	Estimate FY 2010
Opening Fund Balance	**$145**	**$288**	**$100**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$288**	**$100**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,412	$1,587	$1,591	$1,640	$1,687	$1,731	$1,771
Operating and Miscellaneous	617	538	425	428	441	454	479
Transfers between TTF and GF	-155	0	50	0	0	0	0
MdTA Transfer	43	43	43	43	0	0	0
Net Revenues Subtotal	1,917	2,168	2,109	2,111	2,128	2,185	2,250
Bonds Sold	320	275	260	85	110	190	185
Bond Premiums	10	0	0	0	0	0	0
Total Revenues	**$2,247**	**$2,443**	**$2,369**	**$2,196**	**$2,238**	**$2,375**	**$2,435**
Expenditures							
Debt Service	$135	$159	$160	$141	$150	$165	$183
Operating Budget							
State Capital	863	1,257	907	696	683	751	744
Total Expenditures	**$2,104**	**$2,622**	**$2,368**	**$2,196**	**$2,238**	**$2,375**	**$2,435**
Debt							
Debt Outstanding	$1,186	$1,345	$1,513	$1,531	$1,567	$1,672	$1,760
Debt Coverage – Net Income	3.5	4.9	4.9	4.5	3.9	3.4	3.1
Local Highway User Revenues	**$480**	**$551**	**$548**	**$565**	**$580**	**$594**	**$607**
Transferred to General Fund	102	102	0	0	0	0	0
Net Highway User Revenue to Counties	**$377**	**$449**	**$548**	**$565**	**$580**	**$594**	**$607**
Capital Summary							
State Capital	$863	$1,257	$907	$696	$683	$751	$744
Total Federal Capital (Cash Flow)	622	732	758	690	640	479	476
GARVEE Bond Repayment	0	0	20	40	60	60	60
Net Federal Capital to TTF	622	732	738	650	580	419	416
Total Capital Expenditures	**$1,485**	**$1,989**	**$1,645**	**$1,346**	**$1,263**	**$1,170**	**$1,160**

GARVEE = Grant Anticipation Revenue Vehicle

Source: Department of Legislative Services

1.9 percent in each of fiscal 2005 and 2006 and by 2 percent in each year thereafter. The TTF received $718 million in titling tax revenues in fiscal 2004; these revenues are projected to show slow growth of 1.2 percent in fiscal 2005 and 1 percent in fiscal 2006, and then to show stronger growth in each year thereafter, beginning with growth of just over 5 percent in fiscal 2007.

The TTF received $107 million in corporate income tax revenues in fiscal 2004. The forecast assumes that the TTF's portion of the corporate income tax will increase to $129.9 million in fiscal 2005; in addition, the forecast also assumes that the TTF will receive at least $47.5 million in one-time receipts from Delaware holding company settlements.

From fiscal 2002 to 2004, a total of $314.9 million has been diverted from the TTF to the general fund. Chapter 430 of 2004 requires that part of an unappropriated general fund surplus must be appropriated to the State Reserve Fund two fiscal years after the surplus is received. The first $10 million of the surplus is retained by the general fund; the next $11 million to $60 million of the surplus is transferred to the TTF annually until the entire amount of the money transferred from the TTF to the general fund has been repaid. The general fund finished fiscal 2004 with an unappropriated surplus of $309.7 million; as a result, the TTF forecast assumes that the first repayment of $50 million will be made from the general fund to the TTF in fiscal 2006.

Debt Financing

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 legislative session, this limit was raised to $2 billion concomitant with the adoption of increases in vehicle registration fee rates.

From fiscal 1993 to 2001, MDOT issued a total of only $315 million in new debt. By contrast, from fiscal 2002 to 2004, MDOT has issued $815 million in new debt. MDOT expects to continue to issue significant amounts of new debt in the near term. MDOT projects total consolidated transportation bond sales of $275 million in fiscal 2005 and $260 million in fiscal 2006. Consequently, the fiscal 2005 debt service payment is expected to total $160 million (an increase of 19 percent over the fiscal 2004 payment). The proposed level of debt to be issued for fiscal 2005 through 2010 totals $1,105 million. As a result, total debt outstanding is projected to reach $1,760 million by fiscal 2010.

Capital Expenditures

Based on the revenue assumptions detailed above, the forecast yields just over $5 billion during the fiscal 2005 - 2010 period for special fund expenditures on capital projects. Combined with anticipated federal transportation aid, the forecast assumes that MDOT will be able to maintain an annual capital program of at least $1.2 billion through fiscal 2008.

A total of $240 million in federal aid that is expected to be available to the State through federal authorizations is not programmed during the fiscal 2005 - 2010 period. This money is held in reserve in anticipation of the repayment of a grant anticipation revenue vehicle (GARVEE) issuance to be made by the Maryland Transportation Authority to fund construction of the InterCounty Connector.

Operating Budget

Federal Funds Outlook

Due to the slow pace of congressional appropriations, predictions regarding funding levels are difficult. House–Senate conferences have yet to begin for several bills that govern state and local aid. While the President's proposed budget for federal fiscal 2005 is generally status quo, larger reductions are speculated to occur in the out-years (under the current Administration). A bright spot in the federal funds picture is a potentially significant increase in federal homeland security funding if recommendations of the National Commission on Terrorist Attacks upon the United States (9/11 Commission) are enacted. How Maryland will fare in the federal transportation program is unknown as Congress delayed program reauthorization, pending resolution of differences between Congress and the White House over the aggregate funding level.

Federal Aid Continues to Seesaw

While committees of both houses of Congress consistently added money above the President's request in several areas, particularly law enforcement, the House also adopted cuts to housing programs below the Administration's recommendation (except for Section 8 rental vouchers, which received a 13 percent boost over the President's proposal). The House Appropriations Committee recommended important changes to the administration of the Section 8 program, such as directing the U.S. Department of Housing and Urban Development to remove part of the one-month program reserves used by local housing authorities and reducing the administrative fees paid to local agencies for operating the program.

The House also approved significant cuts for wastewater construction grants to state, municipal, and county governments, but these reductions, as well as the proposed housing decreases, will likely meet resistance in the Senate. Most other program areas appear to be headed for mainly flat funding, though grants for local and state law enforcement grants may decline from last year. The federal six-year transportation program that subsidizes state and local transit and highway projects will operate at current levels until June 2005. The Senate Appropriations Committee approved a 9 percent increase for Title I aid to schools in disadvantaged areas but cut in half the President's request for Reading First state grants.

While certain tax receipts are on the rise, the federal government is still grappling with both a $413 billion budget deficit and the cost of combat in Iraq. Looking beyond 2004, concerns have been raised about possible future (and deeper) cuts to many domestic programs, based on a memorandum from the Office of Management and Budget to federal agencies that provided specified funding levels for fiscal 2006. However, the memorandum does not represent a final policy decision.

The budget outlook for homeland security funding is somewhat brighter. The 9/11 Commission recommended that Congress and the President "base federal funding solely on risks and vulnerabilities, putting New York City and Washington, DC at the top of the current list." Consequently, Maryland representatives foresee substantial increases in aid (as high as 50 percent) for the State if this approach is adopted. At publication time, the bill was under negotiation to resolve disputes over proposals to shift budgetary authority and create a civil liberties board.

Congress adjourned for the election after sending only four appropriations bills to the President (homeland security, defense, military construction, and funding for the District of Columbia). Consistent with the pattern of previous years, the House has reported all 13 bills, while the Senate faces significant appropriations work when it returns November 16. Seven Senate floor votes remain, including most state grant programs, and one bill, energy and water appropriations, has yet to pass out of committee.

Federal lawmakers appear to be cutting back somewhat on earmarks (discretionary funds) for special projects, following a considerable level of generosity in fiscal 2004. Maryland garnered at least $26 million for a wide range of purposes in last year's budget, as well as approximately $143 million for new and ongoing transportation projects. **Exhibit 1** shows appropriations included in the federal fiscal 2005 appropriations bills that Maryland may receive for special projects. The list is not all inclusive but highlights projects that were passed by the House or Senate committee; their final status will depend on House/Senate conferences, most of which were not completed at publication time.

Exhibit 1

Potential Federal Spending for Maryland

(Fiscal 2005 Appropriations Bills)

Purpose of Funds	Amount
Transportation*	
Double tracking for Baltimore City Light Rail	$29,010,000 (H)
Extension of MetroRail Blue Line from Addison Road to Largo Town Center	75,430,000 (H)
Baltimore-Washington International Airport (capacity improvement)	7,748,000 (S)
Hagerstown Regional Airport (capacity improvement)	8,000,000 (S)
Community Development/Environment	
Regional pilot demonstration program in the Chesapeake Bay for nonpoint source reduction in small watersheds	10,000,000 (S)
C & O Canal National Historic Park (rehabilitation of Great Falls Visitor Center)	1,776,000 (S)
Fort Washington Park (stabilization)	3,660,000 (S)

Purpose of Funds	Amount
Community Development/Environment (continued)	
Wastewater infrastructure improvements in the cities of Salisbury, Cambridge, and Elkton	750,000 (H)
Wastewater infrastructure improvements in nine towns and cities (excluding Salisbury and Cambridge)	4,250,000 (S)
Low impact development demonstration project in the Anacostia Watershed (Prince George's County)	1,000,000 (S)
Eastern Mid-shore Chesapeake Bay Island feasibility study to restore habitat	1,000,000 (H)
Acquisition and redevelopment of Lexington Manor in St. Mary's County	250,000 (H) 500,000 (S)
East Baltimore Development, Inc. for redevelopment activities	1,000,000 (S)
Pedestrian improvements and linkages in Long Branch and Fenton Street Village	400,000 (S)
Law Enforcement (grant recommendations)	
Montgomery County Police Department for National Capital Regional Criminal Identification System Update under Community Oriented Policing Services (COPS)	1,400,000 (S)
COPS technology improvement grant for the City of Rockville	900,000 (S)
Wireless, high-speed network for Prince George's County (COPS)**	400,000 (S)
University of Baltimore Forensic Science laboratory (DNA backlog elimination program)	500,000 (S)

*Few earmarks are provided for transportation projects, pending the reauthorization of all federal transportation aid. Funding for BWI and Hagerstown reflect the committee's recommendation that the Federal Transit Administration enter into a letter of intent. The House also favored BWI improvement projects as a funding priority.

**The House adopted language recommending a COPS grant for Prince George's County but did not specify a funding level.

Sources: House and Senate Committee Reports for Fiscal 2005 Appropriations for Departments of Commerce, Justice, and State; Energy and Water Development; Departments of Transportation and Treasury; Departments of Veterans' Affairs and Housing and Urban Development; Department of the Interior

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Capital Program

Debt Affordability

The Capital Debt Affordability Committee has recommended a general obligation bond debt limit totaling $670 million for fiscal 2006, an increase of $15 million over the amount authorized for fiscal 2005.

Capital Debt Affordability Process

State law requires the five-member Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt on a continuing basis to help ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretaries of Transportation and Budget and Management, and a public member. Tax-supported debt consists of general obligation (GO) debt, transportation debt, bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes (BANs/RANs). The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new general obligation and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, bay restoration bonds, or Stadium Authority debt but does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

The committee's benchmarks for determining whether State debt is affordable are as follows: (1) total tax-supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and (2) total debt service on tax-supported debt should not exceed 8 percent of revenues. The committee's analysis of debt affordability for the fiscal 2005-2010 period indicates that debt outstanding and debt service ratios will remain within the affordability limits for this period as indicated in **Exhibit 1.**

Exhibit 1
Affordability Ratios
Fiscal 2005 – 2010

Fiscal Year	Projected Debt Outstanding as % of Personal Income	Projected Debt Service as % of Revenues
2005	2.81%	6.18%
2006	2.84%	6.22%
2007	2.82%	6.02%
2008	2.81%	6.12%
2009	2.85%	6.30%
2010	2.89%	6.48%

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

Recommended New Debt Authorization

The committee has preliminarily recommended $670 million in new general obligation debt authorization for fiscal 2006. The recommendation, which is consistent with what was proposed for fiscal 2006 in last year's report, is $15 million more than authorized in fiscal 2005. The fiscal 2006 recommendation includes a planned $5 million for tobacco buyout financing, as required by Chapter 103 of 2002. By the end of fiscal 2006, the committee estimates that total GO debt will be just under $4.7 billion.

The CDAC report also notes that the Task Force on Public School Facilities has recommended that the State authorize $2 billion for public schools' capital projects over the next eight years. The task force also asked that CDAC review this proposal. Insofar as currently proposed authorizations are $800 million, implementing this proposal would require an additional $1.2 billion in GO bond authorizations. CDAC reviewed the task force's proposal and noted that, all other things equal, this debt is affordable through fiscal 2010. However, the committee recommended that the State first explore "alternative funding mechanisms, new revenue streams, or shifting other capital projects before considering an additional $1.2 billion in general obligation bond authorizations."

The University System of Maryland, Morgan State University, and St. Mary's College have the authority to issue debt for academic facilities as well as debt for auxiliary facilities. Proceeds from academic debt issues are used for facilities that have an education-related function (classrooms, labs, etc.). Debt service for these bonds is paid with tuition and fee revenues. For fiscal 2006, CDAC has recommended $25 million for academic facilities on University System of Maryland campuses. This recommendation is $8 million less than the $33 million recommended and authorized for fiscal 2005.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other Department of Transportation revenues. Total outstanding transportation debt is projected to reach almost $1.6 billion in fiscal 2006.

Capital leases for real property and equipment are secured by the assets leased and are paid with appropriations made to the agencies using the leased items. Debt outstanding for leases is expected to be $161 million at the end of fiscal 2006.

Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County conference center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be $296 million at the end of fiscal 2006.

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Capital Program

Capital Funding Requests Exceed Resources

Requests for capital project funding again greatly exceeds the funding available from general obligation bonds and pay-as-you-go (PAYGO) funds. In particular, general fund PAYGO funding is likely to continue to be constrained by economic factors that limit available State general fund revenues. Additionally, as has been the case with the past two budgets, it is possible that special fund PAYGO funds derived from the State transfer tax may continue to be diverted to the State general fund to help with balancing the budget.

General Obligation Bonds

The Capital Debt Affordability Committee (CDAC) has preliminarily recommended a $670 million limit on the amount of new general obligation (GO) debt authorizations by the 2005 General Assembly to support the fiscal 2006 capital program. The recommendation is $15 million higher than the authorizations subject to the general obligation limit for fiscal 2005 and includes $5 million for tobacco buyout financing as required by Chapter 103 of 2002.

The CDAC forecast assumes that general obligation bond authorizations will continue to increase $15 million each year over the five-year forecast period. However, beginning in fiscal 2010, the five-year initiative recommended by CDAC in September 2003 to maintain an annual general obligation bond authorization $95 million higher than what was originally recommended by the committee in September 2002 for fiscal 2005 through 2009 will expire. Despite the increased authorizations provided in the first four years of the five-year forecast period and the annual $15 million annual incremental increase, general obligation bond funding requests exceed the projected limits by over $1.4 billion during the forecast period. **Exhibit 1** provides a summary of the general obligation bond requests for the next five years.

Exhibit 1
GO Bond Requests: Fiscal 2006 – 2010
($ in Millions)

			Fiscal Years				Category
	2006	**2007**	**2008**	**2009**	**2010**	**Total**	**Totals**
State Facilities							$496.7
Board of Public Works	$101.2	$66.5	$55.6	$129.6	$125.7	$478.8	
Military	0.0	2.1	2.9	1.0	2.5	8.5	
Dept. Disabilities/Veterans Affairs	2.2	2.2	1.9	1.6	1.6	9.5	
Health and Social Services							544.1
Health and Mental Hygiene	15.1	25.1	86.1	163.7	90.9	381.0	
University of MD Medical System	15.0	5.0	10.0	12.5	10.0	52.5	

Exhibit 1 (Continued)
GO Bond Requests: Fiscal 2006 – 2010
($ in Millions)

	Fiscal Years						Category
	2006	2007	2008	2009	2010	Total	Totals
Senior Citizen Activity Center	2.6	1.2	1.2	1.2	1.2	7.4	
Juvenile Justice	6.8	9.6	28.8	8.0	25.0	78.2	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							324.1
Natural Resources	20.0	13.0	13.0	13.0	13.5	72.5	
Agriculture*	6.5	7.0	7.3	7.5	8.0	36.3	
Environment	38.0	38.4	37.4	38.2	37.7	189.6	
MD Environmental Service	3.1	5.9	5.2	5.4	6.1	25.8	
Education							619.8
Education	0.0	0.7	50.5	0.0	0.0	51.2	
MD School for the Deaf	1.1	21.9	5.9	1.1	0.0	30.0	
Public School Construction**	107.8	107.6	107.8	107.6	107.8	538.6	
Higher Education							1,477.4
University System of MD***	171.4	126.7	123.7	134.4	272.8	828.9	
Baltimore City Comm. College	1.0	25.7	6.9	0.3	0.0	33.8	
St. Mary's College	5.6	3.7	14.8	2.1	2.4	28.7	
Morgan State University	41.2	16.4	39.7	31.9	27.7	156.9	
Community Colleges	64.0	70.5	123.4	72.2	52.8	382.9	
Southern MD Higher Educ. Center	0.0	0.8	9.1	0.8	0.0	10.7	
Private Facilities Grant Program	11.5	6.0	6.0	6.0	6.0	35.5	
Public Safety							745.0
Public Safety	102.5	57.9	137.6	148.1	181.5	627.6	
State Police	12.7	13.3	7.1	10.1	0.6	43.9	
Local Jails	29.0	9.3	15.5	7.3	12.5	73.5	
Housing and Economic Development							279.7
Economic Development	20.0	20.0	25.0	25.0	25.0	115.0	
Housing and Comm. Development	27.2	30.0	30.9	25.9	25.4	139.4	
Canal Place	1.2	2.1	0.0	0.0	0.0	3.3	
Historic St. Mary's City	0.0	1.0	10.7	5.0	5.3	22.0	
Legislative Initiatives	15.0	15.0	15.0	15.0	15.0	75.0	90.4
Miscellaneous	36.0	53.0	33.0	26.5	25.5	174.0	74.2
Subtotal Request	**$867.8**	**$767.7**	**$1,022.0**	**$1,010.9**	**$1,087.5**	**$4.735.9**	**$4,735.9**
Tobacco Transition Program	5.0	5.0	5.0	5.0	0.0	20.0	20.0
Total Request	**$873.8**	**$772.7**	**$1,027.0**	**$1,015.9**	**$1,087.5**	**$4,755.0**	**$4,755.9**
Debt Affordability Limits	**$670.0**	**$685.0**	**$700.0**	**$715.0**	**$630.0**	**$3,400.0**	

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

**The Interagency Committee on School Construction received requests in excess of $390 million for fiscal 2006, and the amount included in the request to the Department of Budget and Management only reflects what is planned in the *Capital Improvement Plan*.

***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

PAYGO Funding

General obligation bond funds have traditionally been supplemented with State general and special fund capital appropriations (pay-as-you-go funds (PAYGO)) authorized in the annual operating budget. The use of operating funds to finance capital projects and programs can reduce debt issuance and enables the State to avoid Internal Revenue Service limits on the use of tax-exempt bonds for "private activity" purposes such as economic development and housing programs.[1]

The State's fiscal problems have severely curtailed the use of PAYGO in recent years. **Exhibit 2** shows the fiscal 2004 and 2005 general and special fund capital PAYGO appropriations and PAYGO fund estimates according to the 2004 *Capital Improvement Plan* (CIP) for fiscal 2006 through 2009.

Exhibit 2
Current and Planned Capital PAYGO Expenditures
($ in Millions)

Fund Type	FY 04 Approp.	FY 05 Approp.	FY 06 CIP	FY 07 CIP	FY 08 CIP	FY 09 CIP
General Fund PAYGO	$9,400	$1,200	$0	$0	$0	$0
Special Fund PAYGO	128,973	106,922	229,525	231,275	237,225	242,425
Total	**$138,373**	**$108,122**	**$229,525**	**$231,275**	**$237,225**	**$242,425**

Source: Department of Legislative Services

The figures indicate the almost complete elimination of the use of PAYGO general funds in the most recent State budgets. Furthermore, the Administration's most current CIP does not provide any PAYGO general funds through 2009. The use of PAYGO special funds has also been curtailed in recent budgets. State transfer tax revenues, which support a large portion of the annual PAYGO special fund appropriations, have for the most part been diverted to the State general fund rather than distributed to support Department of Natural Resources (DNR) and Department of Agriculture programs as is required under statutory distribution guidelines.[2]

[1]Restrictions imposed under the federal Tax Reform Act of 1986 generally prevent the use of tax-exempt bond proceeds to finance environmental, housing, and economic development revolving loan programs. Funding for these items is therefore typically requested from general and special PAYGO funds. Additionally, repayment to counties for school construction costs already incurred (forward funded construction) must be made with PAYGO or other alternatives to tax-exempt debt. PAYGO also may be used to fund any capital project based on fund availability.

[2]The 2003 and 2004 session Budget Reconciliation and Financing Acts transferred most of the fiscal 2004 and 2005 transfer tax revenues to the State general fund.

While the 2004 CIP indicates that these revenues would support DNR and agriculture programs beginning in fiscal 2006, this is most likely predicated upon an improved State economic and budgetary outlook.

Revenues and Taxes

Comparative Tax and Revenue Rankings

Maryland State and local government revenues are not high in comparison to other states. However, Maryland relies more on taxes than most states and less on nontax sources of revenue. While the total burden of all taxes in Maryland is quite moderate when measured in terms of the State's economy, it is higher when measured on a per capita basis. Under any measure, Maryland's tax structure relies more heavily on the personal income tax than other states.

State and Local Government Spending

As reflected in **Exhibit 1**, compared to other states, total State and local government revenues and spending in Maryland are not high. Maryland ranks generally in the middle of all states in total State and local government revenues and spending measured on a per capita basis and near the lowest in revenues and spending as a percent of total income of residents. However, Maryland relies more on taxes and less on nontax sources of revenue than most states.

Exhibit 1
State and Local Government Spending and Revenues
Fiscal 2002

	MD Rank % of Total	MD Rank Per Capita	MD Rank Percentage of Personal Income
Total Spending	n.a.	29	50
Total Revenues	n.a.	24	48
Revenues:			
Taxes	3	7	28
Intergovernmental from Federal Government	39	39	44
Charges and Utilities[1]	45	45	48
Miscellaneous[2]	41	38	48

Note: For the rankings, 1 indicates the highest and 51 the lowest.
[1]Charges include higher education tuition, fees and auxiliary revenues, sewer and trash collection, highway tolls, and other user charges and fees. Utilities include gross receipts of publicly-owned utilities (water, gas, electric, and transit).
[2]Miscellaneous revenues include interest earnings, net lottery revenues, liquor store revenues, rents, royalties, fines and forfeitures, special assessments, sale of property, and other revenues.

Source: 2002 Census of Government, U.S. Bureau of the Census (July 2004)

Exhibit 2 and **Exhibit 3** compare Maryland's State and local tax revenues to other states in the region. Maryland's reliance on the income tax is high compared to other states, reflecting the statewide local income tax. Maryland ranks twenty-eighth among all states in overall taxes as a percentage of personal income and seventh in overall taxes on a per capita basis. Relative to other states in the region and in comparison to all states, Maryland generally ranks near the middle with respect to property taxes and near the bottom with respect to corporate income taxes and sales taxes.

Exhibit 2
Maryland State and Local Tax Revenues
Comparison to Selected States
Fiscal 2002 Tax Revenues as a Percentage of Personal Income

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes(1)	License Fees	Other Taxes(2)	All Taxes
District of Columbia							
Percent	3.0%	3.6%	0.8%	3.5%	0.2%	1.0%	12.1%
Rank	26	4	4	27	50	4	3
New Jersey							
Percent	4.7%	2.0%	0.3%	2.6%	0.3%	0.3%	10.2%
Rank	3	36	11	44	40	33	21
Maryland							
Percent	**2.7%**	**3.9%**	**0.2%**	**2.5%**	**0.2%**	**0.5%**	**10.0%**
Rank	**34**	**2**	**39**	**45**	**44**	**17**	**28**
Virginia							
Percent	2.8%	2.8%	0.1%	2.7%	0.3%	0.5%	9.3%
Rank	31	16	44	43	39	19	44
Delaware							
Percent	1.6%	3.0%	1.0%	1.3%	3.0%	0.6%	10.4%
Rank	50	13	2	50	1	10	17
Pennsylvania							
Percent	2.8%	2.5%	0.3%	2.9%	0.5%	0.7%	9.8%
Rank	30	21	15	42	12	7	33
North Carolina							
Percent	2.4%	3.2%	0.3%	3.4%	0.4%	0.2%	9.8%
Rank	41	9	20	33	31	41	34
West Virginia							
Percent	2.1%	2.4%	0.5%	4.6%	0.28	0.8%	10.8%
Rank	43	25	7	11	24	6	10
U.S. Average	**3.1%**	**2.3%**	**0.3%**	**3.6%**	**0.4%**	**0.4%**	**10.2%**

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n.a.," the State does not have that tax.
(1)Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and other taxes.
(2)Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: 2002 Census of Government, U.S. Bureau of the Census (July 2004)

Exhibit 3
Maryland State and Local Tax Revenues
Comparison to Selected States
Fiscal 2002 Tax Revenues Per Capita

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Amount	$1,412	$1,668	$371	$1,644	$88	$489	$5,671
Rank	5	1	2	4	40	3	1
New Jersey							
Amount	$1,872	$801	$128	$1,027	$112	$99	$4,038
Rank	1	17	8	31	29	25	4
Maryland							
Amount	**$993**	**$1,402**	**$66**	**$913**	**$80**	**$192**	**$3,646**
Rank	**17**	**3**	**27**	**41**	**44**	**10**	**7**
Virginia							
Amount	$921	$921	$42	$898	$93	$162	$3,037
Rank	27	11	44	42	39	15	24
Delaware							
Amount	$496	$947	$312	$405	$968	$205	$3,334
Rank	44	9	3	50	1	8	14
Pennsylvania							
Amount	$885	$771	$97	$916	$169	$214	$3,052
Rank	29	19	14	40	11	6	22
North Carolina							
Amount	$653	$875	$80	$945	$110	$55	$2,718
Rank	39	14	17	37	30	40	33
West Virginia							
Amount	$499	$573	$122	$1,097	$97	$183	$2,572
Rank	43	34	10	24	34	11	41
U.S. Average	**$969**	**$704**	**$98**	**$1,125**	**$128**	**$118**	**$3,143**

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n.a.," the State does not have that tax.

[1] Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and other taxes.

[2] Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: 2002 Census of Government, U.S. Bureau of the Census (July 2004)

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Video Lottery Terminals

Legalizing video lottery terminals (VLTs) was again debated in the 2004 session. Legislation authorizing VLTs at racetrack and nontrack locations was proposed by the Governor and amended and passed by the Senate but failed in the House Ways and Means Committee. Pennsylvania recently enacted legislation providing for the legalization of VLTs at various locations, and several VLT facilities at New York racetracks have opened in the last year.

Senate Bill 197 of 2004

Overview

Senate Bill 197 of 2004, as amended and passed by the Senate, would have authorized up to 15,500 video lottery terminals (VLTs) at three horse racing tracks and three unspecified nontrack locations, but the bill failed in the House Ways and Means Committee.

The bill would have created an Education Trust Fund and other special funds, provided for one-time license fees to fund the cost of the Geographic Cost of Education Index (GCEI) program formula in fiscal 2005, and continued the current prohibition on additional forms of commercial gambling. The Education Trust Fund would have been used to fund the provisions of the Bridge to Excellence in Public Schools Act of 2002 (Thornton). The GCEI formula would have been established by the bill to reflect regional differences in the cost of education.

VLT regulation and oversight would have been carried out by the State Lottery Commission. All VLT licensees would have been required to meet specified minority business and capital expenditure requirements, and racetrack licensees would have been required to meet specified conditions related to the horse racing industry.

Video Lottery Facility Location Commission

A Video Lottery Facility Location Commission established by the bill would have determined the distribution of the 15,500 VLTs among the six potential licensees and the percentage of VLT operator shares of the gross proceeds. Members of the commission would have been appointed by the Governor, the President of the Senate, and the Speaker of the House.

Under the bill, three racetrack VLT licenses could be awarded from among Laurel Park, Pimlico Race Course, Rosecroft Raceway, and a proposed racetrack in Allegany County. The nontrack locations would have been selected from among the following eligible jurisdictions: Baltimore City, Cecil County, and Prince George’s County. A racetrack location could receive up to 3,000 VLTs initially, and a nontrack location could receive up to 2,500 VLTs initially.

Revenue Distribution

Exhibit 1 shows how the gross proceeds, after prize payouts, would have been distributed under Senate Bill 197.

Exhibit 1
VLT Revenue Distributions
Senate Bill 197 of 2004

	Racetrack Locations	**Nontrack Locations**
State Lottery (administrative costs)	5% (4.3% in year two and beyond)	5% (4.3% in year two and beyond)
Operator/Licensee	Not more than 36%	Not more than 30%
Purse Dedication Account	9.3% (10% in year two and beyond)	None
Host Counties	5%	5%
Education Trust Fund	44.7% (assuming operator maximum of 36%)	60%, 60.7% in year two and beyond (assuming operator maximum of 30%)

Source: Department of Legislative Services

Additional fees of $390 per VLT terminal for a Compulsive Gambling Fund, administered by the Department of Health and Mental Hygiene, would have been assessed on VLT operation licensees. The fund would have been used to provide problem gambling treatment and prevention services. At full implementation of 15,500 VLTs, approximately $6 million annually would have been generated for the fund.

The Department of Legislative Services (DLS) estimated that approximately $1.6 billion in gross proceeds (after prize payouts but before any revenue distributions) could have been generated once all the proposed VLTs were operating at full market potential in fiscal 2008. Once fully operational, DLS estimated that annual VLT revenue would be approximately $829 million for the Education Trust Fund, $540 million for VLT licensees, $94 million annually to the Purse Dedication Account, and $81 million for local jurisdictions. A potential reduction in traditional lottery revenues of as much as $69.7 million will offset these gains, however.

Video Lottery Terminal Operations in Other States

Delaware and West Virginia

Of Maryland's surrounding states, Delaware and West Virginia currently allow VLTs at racetrack locations. Delaware has three VLT facilities (Delaware Park, Dover Downs, and Harrington Raceway), and West Virginia has four (Charles Town Races, Mountaineer Park, Wheeling Downs, and Tri-State Racetrack). West Virginia also allows for VLT-type machines in bars and restaurants. In 2003 VLTs at racetracks generated gross proceeds of approximately $767 million in West Virginia and $502 million in Delaware.

Pennsylvania's Authorization of Video Lottery Terminals

The Pennsylvania legislature recently passed the Pennsylvania Gaming Act, which authorizes up to 14 VLT venues and a maximum of 61,000 slots. The Act creates an independent Gaming Control Board that will have jurisdiction over every aspect of the authorization and operation of VLTs in the state.

Exhibit 2 shows the maximum number of facilities for each type of facility, the maximum initial number of VLTs each facility can be awarded, the maximum number of additional VLTs that may be awarded after a facility becomes operational, and the license fees to be paid for each facility under Pennsylvania's legislation.

Exhibit 2
Pennsylvania Gaming Act
Number and Types of Slots Venues

Facility Type	Maximum Number of Locations	Maximum Initial VLTs	Maximum Additional VLTs	License Fee (millions)
Racetrack	7	3,000	2,000	$50
Nontrack	5	3,000	2,000	50
Resort/Hotel	2	500	0	5
Totals	**14**	**37,000**	**24,000**	**$610**

Source: Department of Legislative Services

From all Pennsylvania VLT facilities, the anticipated revenue distribution once all facilities are fully operational is:

- approximately 48 percent to operators;
- 34 percent to the State;
- approximately 9 percent to a horse development fund;
- 5 percent for economic development and tourism programs; and
- 4 percent to host municipal and county governments.

The legislature is currently considering altering several provisions of the legislation and selection of the members of the Gaming Control Board has yet to be completed. At this time, it appears that facility licenses might be awarded beginning in late 2005. It is expected that existing racetrack facilities will begin operating VLT facilities in mid to late 2006, and newly constructed facilities will begin operating in 2007. Although Pennsylvania authorized up to 61,000 VLTs, legislative staff with the Pennsylvania State Senate estimate that it is likely a maximum of 40,000 VLTs will ultimately be in operation. Based on this number of VLTs, the Senate staff estimates approximately $3.0 billion in gross proceeds, with $1.0 billion for the state, will be generated once the VLTs are operating at full market potential.

Video Lottery Terminal Developments in Nearby Jurisdictions

Two nearby jurisdictions with notable VLT developments include:

- Washington, DC – The City Elections Board disallowed a controversial petition drive proposing to add a general election ballot question to authorize 3,500 VLTs in northeast Washington, DC.
- New York – A total of approximately 5,000 VLTs began operating at four New York racetracks: Saratoga Springs, Finger Lakes Raceway, Buffalo Raceway, and Monticello. Four more racetracks are expected to begin VLT operations in 2005. Operators receive approximately 20 percent of net revenues, and the State receives 61 percent for education funding. The remainder is split among administrative costs (10 percent), purse enhancements (7.5 percent), and Breeders Fund (1.25 percent). The distribution of the 29 percent share among tracks, breeders, and purse enhancements will change over time, with the operators' share eventually declining to 17.48 percent with a corresponding increase in the Breeders Fund and purse enhancements.

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Personnel

State Workforce and Payroll

Fiscal 2005 is the third year in which limits have been placed on the number of regular and contractual positions, necessitating a reduction of 350 Executive Branch positions. This mechanism has served to constrain State spending for total employee compensation; however, spending on employee health insurance has increased dramatically. Total regular compensation has increased by $299 million, while spending on health insurance has increased $208 million during the fiscal 2002 – 2005 period.

Budgeted Positions

Regular Positions

Section 40 of the fiscal 2005 budget bill (Chapter 429 of 2004) established a limit of 52,834 on the number of regular full-time equivalent (FTE) positions that may be filled in non-higher education Executive Branch agencies. This limit required the abolition of 350 FTEs, half of which were to be in the officials and administrators job family or positions that supplied government relations, legislative liaison, or public information services. Primarily due to the use of Executive Branch position caps and the resulting position abolitions, the regular employee workforce has contracted from 82,087 in fiscal 2002, the year before position caps were first implemented, to 78,095 in the fiscal 2005 working appropriation. Approximately 95 percent of the decrease can be accounted for by 9 out of a possible 22 agencies or service areas, as shown in **Exhibit 1**. Since fiscal 2002, a net total of 3,992 FTE positions have been abolished statewide.

Fiscal 2005 Additions and Abolitions

To reach the Executive Branch position cap of 52,834 in fiscal 2005, the Department of Budget and Management proposed and the Board of Public Works approved 361 FTE abolitions, 43 of which were filled positions. Since the beginning of fiscal 2005, 277 positions have again been added, 249 of which are in higher education institutions.

Higher Education

Chapters 239 and 273 of 2004 have provided the University System of Maryland and Morgan State University (MSU) with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2004, the impact of this legislation has been to add 34 FTE positions at MSU, 14 FTE positions at St. Mary's College, and 201 FTE positions at the University

Exhibit 1

Regular Full-time Equivalent Positions

Fiscal 2002 Actuals to 2005 Working Appropriation

Department/Service Area	FY 2002 Actual	FY 2005 Working Approp.	Change: FY 2002 to 2005	Cumulative % of Total Change
Health and Mental Hygiene	8,536	7,548	(988)	24.7%
Human Resources	8,273	7,303	(969)	49.0%
Transportation	9,538	9,044	(495)	61.4%
Public Safety and Correctional Services	11,663	11,195	(468)	73.1%
Labor, Licensing, and Regulation	1,706	1,490	(216)	78.5%
Natural Resources	1,629	1,428	(201)	83.6%
Higher Education	21,386	21,215	(171)	87.9%
Juvenile Services	2,123	1,963	(160)	91.9%
Financial and Revenue Administration	2,158	2,035	(124)	95.0%
Police and Fire Marshal	2,590	2,479	(111)	97.7%
Environment	1,028	943	(85)	99.9%
General Services	793	712	(81)	101.9%
Housing and Community Development	449	386	(63)	103.5%
Budget and Management	524	468	(56)	104.9%
Executive and Administrative Control	1,619	1,566	(53)	106.2%
Agriculture	480	430	(50)	107.4%
Business and Economic Development	324	299	(25)	108.1%
MSDE and Other Education	1,955	1,938	(17)	108.5%
Retirement	194	180	(14)	108.8%
Legal	1,381	1,511	130	105.6%
Executive Branch Subtotal	**78,347.1**	**74,131.9**	**(4,215.2)**	
Legislative	730	739	9	105.4%
Judiciary	3,010	3,224	214	100.0%
Total	**82,086.8**	**78,094.6**	**(3,992.2)**	

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

System of Maryland for fiscal 2005, a 1.2 percent total increase in staff over fiscal 2004. Some of the increase is likely related to projected increases in student enrollment. During fiscal 2005, student enrollment is projected to increase approximately 2.0 percent over fiscal 2004 levels. Higher education and other position changes attributable to the "Rule of 50" (Section 18, Chapter 429 of 2004), through which 50 State-funded positions may be added to the legislative appropriation with Board of Public Works approval, are noted in **Exhibit 2**.

Exhibit 2
Regular Full-time Equivalent Positions
Fiscal 2004 Actuals to 2005 Working Appropriation

Department/Service Area	FY 2004 Actual	FY 2005 Leg. Approp.	BPW & Other Changes	FY 2005 Working Approp.
Legislative	730	739	-	739
Judiciary	3,224	3,224	-	3,224
Legal	1,445	1,511	-	1,511
Executive and Administrative Control	1,572	1,563	3	1,566
Financial and Revenue Administration	2,032	2,030	5	2,035
Budget and Management	472	468	-	468
Retirement	181	179	1	180
General Services	728	716	(4)	712
Transportation	9,096	9,044	-	9,044
Natural Resources	1,454	1,429	(1)	1,428
Agriculture	434	430	-	430
Health and Mental Hygiene	7,710	7,547	1	7,548
Human Resources	7,379	7,281	22	7,303
Labor, Licensing, and Regulation	1,519	1,490	-	1,490
Public Safety and Correctional Services	11,231	11,195	-	11,195
MSDE and Other Education	1,892	1,938	-	1,938
Housing and Community Development	393	386	-	386
Business and Economic Development	299	298	1	299
Environment	951	943	-	943
Juvenile Services	1,939	1,963	-	1,963
Police and Fire Marshal	2,480	2,479	-	2,479
Subtotal	**57,159**	**56,851**	**28**	**56,879**
Higher Education	20,966	20,966	249	21,215
Total	**78,125**	**77,818**	**277**	**78,095**
Non-higher Education Executive Branch Total	**53,205**	**52,889**	**28**	**52,917**

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

Regular and Contractual Average Compensation and Total Expenditures

Regular Positions

The budgeted expenditure per regular FTE position in fiscal 2005 is approximately $64,613, of which $46,431 is attributable to salaries, $1,519 to salary enhancements (overtime, shift differential, and reclassifications), and $16,663 to fringe benefits. Fringe benefits include health insurance, retirement benefits, social insurance (Social Security, unemployment insurance, workers' compensation), and discretionary employee benefits. While the number of regular positions has decreased since fiscal 2002 by 5.2 percent, as demonstrated in **Exhibit 3** funding devoted to regular employee compensation has increased by 6.3 percent. The largest component of this increase is spending for health insurance. The State is spending approximately $208 million more in fiscal 2005 than it did three years ago, a 42.7 percent increase. In all, the State of Maryland is spending $5.0 billion for its regular employee workforce.

Exhibit 3
Fiscal 2002 Actuals and Fiscal 2005 Legislative Appropriation
($ in Millions)

	FY 2002 Actuals	**FY 2005 Leg. Approp.**	**Growth Rate FY 2002-2005 Leg. Approp.**
Regular Employees			
Full-time Equivalent Positions	82,087	77,818	-5.2%
Regular Salary*	$3,458.0	$3,613.1	4.5%
Other Earnings (Overtime, Shift Differential, etc.)	137.9	118.2	-14.3%
Total Salary	**$3,595.9**	**$3,731.3**	**3.8%**
Health Insurance	$486.7	$694.6	42.7%
Pensions/Retirement*	239.9	226.7	-5.5%
Variable Fringes (Social Security, Unemployment)*	$258.6	$279.3	8.0%
Other Fringes	113.6	66.8	-41.2%
Other	34.6	29.2	-15.4%
Total Regular Payments	**$4,729.2**	**$5,028.0**	**6.3%**
Contractual Employees			
Full-time Equivalent Positions	8,907	9,327	4.7%
Contractual Salary	$160.3	$184.3	14.9%
Total Fringes	12.3	14.7	19.1%
USM Contractual	$211.1	$216.8	2.7%
Total Contractual Payments	**$383.7**	**$415.7**	**8.3%**
Total Regular and Contractual Payments	**$5,112.9**	**$5,443.7**	**6.5%**

*Turnover and cost containment were distributed among regular salaries, pensions/retirement, and variable fringes in fiscal 2004 and 2005. They were not distributed to health insurance; agencies may not transfer those funds out of the health insurance subobjects (Section 17, 2005 budget bill).

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

Contractual Positions

The budgeted expenditure per contractual FTE position in fiscal 2005 is approximately $44,571, 3.5 percent more than in fiscal 2002; unlike regular positions, contractual positions are not paid health insurance, pensions, or other benefits, with the exception of Social Security, unemployment compensation, and workers' compensation.

From fiscal 2002 to the fiscal 2005 working appropriation, the number of contractual FTE positions has increased by 420 FTE positions, or 5 percent. Section 40 of the 2005 budget bill also implements a position cap for Executive Branch contractual positions of 2,811 FTE positions. This is the third year in which contractual position caps have been used, and have served to constrain spending in this area. Spending for contractual positions has increased slightly since fiscal 2002, by $32 million, or 8.3 percent.

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Personnel

Employee Health Insurance

In an effort to control State spending, the Department of Budget and Management is attempting to change health benefit plans for 2005, primarily by shifting more of the cost of health benefits to State employees and retirees. Fiscal 2005 budget language, however, requires the department to provide benefits at the same cost in 2005 as it did in 2004, unless it and employee labor organizations can agree on different rates. Negotiations have not yet taken place and plan design has yet to be determined.

Background

The State offers a variety of health plans, many on a pre-tax basis, to State employees, retirees, and their qualifying dependents. Eligible individuals may choose from among two preferred provider options (PPOs), three point-of-service (POS) plans, and three health maintenance organization (HMO) plans for their medical coverage. In addition, the State also offers insurance coverage for mental health/substance abuse, prescription drugs, dental, term life, accidental death and dismemberment, and long-term care.

The State has traditionally subsidized all or part of health insurance premiums for employees and retirees. The State contributes toward the cost of employee coverage as follows: 80 percent for PPO plans, 85 percent for POS and HMO plans, 80 percent for prescription drug coverage, and 50 percent for dental coverage. The State does not contribute for term life, accidental death and dismemberment, or long-term care coverage. For retirees, the State contributes the same subsidy percentages for retirees who have at least 16 years of creditable service.

The State Looks to Stem Its Rapidly Increasing Health Insurance Costs

Facing a $42 million deficit in fiscal 2005 and another round of double-digit inflation for health benefits costs for fiscal 2006, the Department of Budget and Management (DBM) has been exploring a variety of ways to stem its rapidly increasing health insurance costs. In order to avert such high State costs and close the current deficit, DBM has proposed changes in plan design for calendar 2005 benefits. Primarily, these changes require State employees and retirees to assume more of the cost of their benefits. These types of changes conflict with fiscal 2005 budget language that requires DBM to provide the same health benefits at the same cost in calendar 2005 as in 2004, unless DBM and State employee labor organizations are able to negotiate different insurance rates.

Cost Sharing for Employees and Retirees Still Undetermined

DBM's inability as yet to negotiate cost-sharing requirements with labor organizations has led to a severe delay in determining final plan design and offering the required open enrollment period in which employees and retirees may choose benefits for next year. Despite the budget language requirements mandating agreement, DBM moved unilaterally to modify cost-sharing arrangements in an attempt to reduce health benefits costs.

The State's medical and dental benefit contracts expired this year, requiring DBM to rebid them. When DBM sought proposals for new contracts, DBM's requests for proposals included changes to medical plan copayments, benefit levels, and dependent coverage that shifted more of the costs of health care coverage to enrollees. Based on these modified plan designs, DBM awarded, and the Board of Public Works approved, medical plan contracts to MAMSI, CareFirst of Maryland, and Kaiser Foundation Health Plan, totaling almost $3.5 billion over the next five years. The board approved these contracts on September 8, 2004.

While DBM awarded contracts based on a modified plan design, to date, it has not been able to come to any agreement with labor organizations regarding these changes. Although DBM continues to attempt to negotiate cost-sharing changes with labor organizations, DBM believes the 2005 budget language is invalid. DBM sought advice of counsel on the legality of the budget language restricting cost-sharing changes, and its Assistant Attorney General advised the department that the General Assembly could not adopt language that had the effect of increasing an appropriation.

On November 22, 2004, DBM decided to delay most cost increases for the first six months of 2005 to permit more time for the State and labor organizations to negotiate plan design and costs. The State is expected to offer an abbreviated open enrollment in December for health benefits through June 30, 2005. There will be a separate open enrollment for a new benefit plan year beginning July 1, 2005, that coincides with the State's fiscal year. Some copayments are expected to increase for the first six months, saving the State about $10.4 million (total funds) in fiscal 2005.

Projected Savings of DBM's Cost-sharing Proposals

DBM is proposing several changes to the current plan design in order to reduce fiscal 2005's projected deficit. In general, these proposals include increasing the percentage of total premiums paid by employees and retirees, increasing copayment amounts in medical and prescription drug plans, offering a mail order prescription drug option, and tightening prior authorization requirements for certain drugs. Projected annual savings from plan design changes range from $1.5 million from adding a mail order prescription drug option to $85.8 million from increasing employees' premium share for dependent coverage from 15 to 20 percent (depending on type of plan) to 50 percent.

Other Large Group Employers Facing Similar Decisions

The State's struggle to maintain affordable and comprehensive health benefits for its employees and retirees is not unique. Large group employers, including other state governments, are seeking ways to stave off large premium increases. Other than increasing the share that employees pay, employers have explored whether approaches such as disease management, more stringent managed care networks, and wellness programs could help. In general, employers do not find sufficient savings with these alternatives and are turning instead to shifting more of the cost burden to employees. When asked in one survey about changes employers may make in the near future, 52 percent of all large group employers are very likely to increase employee premium contributions. Smaller numbers are very likely to raise deductibles (9 percent), raise office visit cost sharing (5 percent), raise prescription drug copayments (5 percent), introduce a tiered network for physicians (2 percent), restrict eligibility for benefits (1 percent), or drop coverage altogether (3 percent).

In 2004 the average monthly premium for state employees nationally is $835.44, of which the employee pays $161.13 (19.3 percent) and the state pays $674.31 (80.7 percent). This average premium is slightly higher than Maryland's, where the average monthly premium is $713.10, of which the employee pays $121.17 (17 percent) and the State pays $591.93 (83 percent). While Maryland's average premium is lower, it is important to note that plan design and coverage levels vary greatly among the states' plans.

Most states have made or are considering changes to their prescription drug coverage, which recently has been the biggest cost driver. These changes include increasing copayment amounts, imposing deductibles, requiring generic drug substitutions, implementing preferred drug lists, and entering into multistate prescription drug contracts.

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Personnel

Pension Contribution Rates and Funding Levels

The State Retirement and Pension System of Maryland earned a 16.4 percent investment return on a market value basis in fiscal 2004. The contribution rate for the employees' system will increase in fiscal 2006 based on the "corridor" method because the system is 89.2 percent actuarially funded, outside of the 90 to 110 percent funding corridor. While the rate for the teachers' system will remain unchanged, the teachers' system will likely fall out of the funding corridor in fiscal 2007 unless market investment returns exceed 15 percent in fiscal 2005.

Fiscal 2004 Investment Returns and Impact on State Actuarial Funding

The State Retirement and Pension System earned an investment return of 16.5 percent of market value for fiscal 2004. This contrasts to the previous three fiscal years, which suffered negative or poor investment returns. The investment return rate increased from -9.4 percent in fiscal 2001 to the most recent 16.5 percent. On an actuarial basis, however, the investment return for fiscal 2005 was only 5.2 percent, as all returns are smoothed over a dynamic five-year span. This method mutes the effects of an inordinately high or low rate of investment return for any given year.

The contribution rates for the two largest systems, the employees' and teachers' systems, are fixed from year to year as long as funding for these systems remains in a "corridor" of actuarial funding from 90 to 110 percent. Should the funding level fall out of this corridor, the rates must be adjusted to account for a percentage of the difference between the prior year's rate and the "true" actuarial rate. The true rate funds both the normal cost (all future liability) and a component of any unfunded accrued liability, which is amortized on a 25-year schedule. This method has been in place since fiscal 2003. The annual actuarial valuation of the State Retirement and Pension System showed that the employees' system is 89.2 percent actuarially funded. Under the corridor method, the contribution rate must increase from 4.73 percent of payroll in fiscal 2005 to 5.76 percent in fiscal 2006.

As the teachers' systems are 92.8 percent funded, the State contribution rate will remain unchanged under the corridor method. However, unless market investment returns exceed 15 percent for fiscal 2005, the Teachers' Pension system will likely fall out of the 90 to 110 percent funding corridor.

In aggregate, taking into account all the various systems, the State Retirement and Pension System is 91.2 percent funded on an actuarial basis and remains actuarially sound. The aggregate State contribution rate in fiscal 2006 will be 8.46 percent of payroll, up from 7.97 percent of payroll in fiscal 2005. **Exhibit 1** shows the new contribution rates and funding level by each individual system as well as the aggregate State system.

Exhibit 1
Fiscal 2005 and 2006 Employer Contribution Rates

Plan	FY 2005 Rate	FY 2006 Rate	Actuarial Funding Level
Employees	4.73%	5.76%	89.2%
Teachers	9.35%	9.35%	92.8%
State Police	0.00%	8.22%	107.2%
Judges	36.72%	41.12%	80.1%
Law Enforcement Officers	37.73%	38.47%	63.3%
Aggregate	**7.97%**	**8.46%**	**91.2%**

Note: Funding levels reflect State funds only and exclude any municipal contributions or funds.

Source: Milliman USA

Error in Coding Reduces Expected State Police Surplus, Raises Contribution Rates

During the 2004 actuarial valuation by Milliman USA, it was discovered that for an unknown period of years, a segment of participants in the State Police (and Judges' and Law Enforcement Officers' systems to a lesser degree) system were being improperly "coded" in the actuarial database engine. The benefits owed to these employees were being computed on a single-life annuity basis, where they should have been coded as joint-and-survivor annuities. As a result, the State Police pension system has long been operating under an assumption that the system was inordinately overfunded. Based on a 0 percent contribution rate in fiscal 2005 and the aforementioned coding error, the State Police surplus fell from $222.8 million to $87.4 million. The contribution rate for the State Police will increase to 8.22 percent of payroll in fiscal 2006. If market investment returns approximate expectations (7 to 8 percent), then the 8 percent contribution will not add to the surplus, rather it will only slow the degradation of the surplus. This occurs because the 8.22 percent contribution does not exceed the normal cost level of 25.05 percent (the present value of the cost of future benefits owed).

Personnel

Pension Legislation

Pension legislation relating to the prefunding of retiree health care, the reemployment of retirees, and special pay plans may be introduced in the 2005 session.

Prefunding of Retiree Health Care

The Government Accounting Standards Board (GASB) has developed standards that will require governmental employers to account for liabilities associated with the employers' commitment to subsidize retiree health insurance. Maryland must account for these liabilities on its balance sheets by fiscal 2007. The GASB standard has two components. First, the value of these retiree health liabilities based on an actuarial valuation needs to be determined. Previous informal estimates of Maryland's liabilities in this regard have been approximately $2 to $3 billion in net present value. Second, a plan will be expected for the accrual of assets to offset these liabilities. Maryland, like most states, currently funds this subsidy on a "pay as you go" basis.

Chapter 466 of 2004 provides a start to prefunding these liabilities by directing anticipated federal revenues associated with employer subsidies for retiree prescription insurance subsidies to a special, off-budget retiree health insurance trust fund. Estimated at around $14 million annually, these federal funds are minimal compared to the total liabilities. To the extent, however, that the funds are above the "pay as you go" costs and can be invested effectively by the State Retirement and Pension System (as provided by the Act), it is the first step toward meaningful prefunding. In the future, however, an ongoing source of additional budgeted funds will be required. The Joint Committee on Pensions is studying this issue in greater detail during the 2004 interim, and the Department of Legislative Services is preparing a report for the joint committee on the subject.

Reemployment of Retirees

Currently, a retiree of the employees' and teachers' systems who receives a service retirement or vested allowance and returns to employment with a participating employer of the State Retirement and Pension System may be subject to an earnings limitation. Retirement benefits are reduced dollar-for-dollar by the amount that the retiree's earnings exceed the difference between the average final salary and the basic allowance at the time of retirement. This limitation applies if the retiree is reemployed with the same employer from which the individual retired or if the retiree becomes reemployed within 12 months of receiving an early service retirement allowance.

Over the past five years, several exemptions from the earnings limitation have been enacted for retired public school teachers, principals or supervisors of principals, and retired health care practitioners (primarily nurses) reemployed on a contractual basis by Department of Health and Mental Hygiene. These exemptions were enacted to address statewide teacher, principal, and nurse shortages. Each exemption was scheduled to terminate July 1, 2004. During the 2004 session, HB 1254 was introduced to extend the reemployment earnings exemptions for these individuals; it also included provisions designed to address perceived abuses of the exemptions. However, the bill did not pass, and all the reemployment exemptions expired on July 1, 2004.

During the 2004 interim, the Joint Committee on Pensions is studying the impact of the expiration of these exemptions on local school systems and the Department of Health and Mental Hygiene. The Department of Legislative Services expects that the sunset of the exemption will lead to a decline in the number of teachers who retire in their first year of eligibility. Teachers who retire sooner pay less employee contributions into the system and collect benefits from the system over a longer period of time. If the existing exemptions for the earnings limitations had been extended during the 2004 session, the Department of Legislative Services estimated that total liabilities for the State Retirement and Pension System would have increased by as much as $56.9 million.

Special Pay Plans

Chapter 302 of 2004 authorizes the Secretary of the Department of Budget and Management to establish a special pay plan for State employees under § 401(a) of the Internal Revenue Code. A special pay plan is a deferred compensation plan organized that allows an employer, in this case the State, to transfer the cash value of the unused annual leave and other undefined contributions at the time of an employee's separation from service into a tax-deferred account on behalf of the employee. Under Chapter 302, eligible State employees are required to deposit the value of their accrued annual leave remaining at the time of retirement into the special pay plan. The employee would be able to manage the investment of the funds with the plan's third-party administrator, take the cash value of the unused annual leave, or roll over the unused annual leave to another qualified tax-deferred plan.

State employees currently receive any unused annual leave as a lump-sum payment in their final payroll transaction. For fiscal 2003, the State paid approximately $17 million in unused annual leave. **Exhibit 1** provides a comparison of the payment of unused annual leave to an employee in a lump-sum cash distribution versus participation in a special pay plan. The employee and employer would each save the 7.65 percent federal payroll taxes for FICA. The employee would also defer payment of federal, State, and local taxes until distributions are made from the plan account.

Exhibit 1
Tax Implications of Lump-sum Distributions vs. Special Pay Plan
Net Employee Payment

	Current Law Lump-sum Distribution	Special Pay Plan
Cash Value of Unused Annual Leave	$10,000	$10,000
Federal Payroll Taxes (FICA) (7.65%)	765	–
Federal Income Tax Withholding (28%)[1]	2,800	Tax Deferred
State and Local Income Tax (4.75% State – 2.9% Local)[2]	765	Tax Deferred
Net Payment to Employee	**$5,670**	**$10,000**

[1]Assumes federal marginal tax rate of 28%.

[2]Reflects average local income tax rate of 2.9%.

Source: Department of Legislative Services

A number of issues raised by Chapter 302 are being considered by the Joint Committee on Pensions during the 2004 interim. First, while the Internal Revenue Service has approved special pay plans in a number of states and in numerous school boards across the county, questions have now started to arise regarding the validity of a plan that requires employees to deposit the value of their accrued annual leave remaining at the time of retirement into a tax-deferred account. The Joint Committee on Pensions is considering whether to submit legislation amending Chapter 302 to clarify that the special pay plan is not effective until the State submits the plan to the Internal Revenue Service for review and receives a favorable ruling on the qualification of the plan.

In addition, Chapter 302 requires the Secretary of Budget and Management to adopt regulations establishing eligibility for the plan. An advice of counsel letter from the Attorney General's office indicates that this provision could be viewed as inconsistent with the requirement of § 401(a) of the Internal Revenue Code that a special pay plan have mandatory contributions and fixed eligibility. While it could be argued that properly adopted regulations have the force of law, eligibility is a critical issue relating to the structure of the special pay plan, and a legislative determination of the matter in statute may be more appropriate and would clearly resolve the legal issues.

Another issue relates to applicability of the special pay plan to various State employees. Under the legislation, the special pay plan is potentially applicable to all individuals in the

Executive Branch agencies and the University System of Maryland. Three separate payroll systems apply to these employees: the Central Payroll Bureau and the Maryland Department of Transportation and University System of Maryland payroll systems. The legislation is unclear as to whether the special pay plan is intended to apply to employees in all three payroll systems.

Education

Significant Education Funding Increases Scheduled for Third Year of Bridge to Excellence Phase-in

With the continued phase-in of the Bridge to Excellence in Public Schools Act, fiscal 2006 State education aid is scheduled to increase by nearly $500 million to a total of $4.1 billion. The estimate assumes $54 million for regional cost adjustments that are not mandated and therefore may be excluded from the budget submitted by the Governor. In addition, a trigger provision that limits growth in State aid unless legislative action is taken could result in a further reduction of $37 million.

Record-breaking Funding Levels Anticipated for Education in Fiscal 2006

Last year, Governor Robert L. Ehrlich, Jr. declared the $320 million increase in State education aid to be the largest in Maryland's history. Preliminary projections of fiscal 2006 aid indicate that the record may be shattered in the upcoming year. The estimated increase is $482 million and will boost the State's contribution to local school systems from $3.6 billion in fiscal 2005 to approximately $4.1 billion in fiscal 2006, an increase of 13.3 percent.

Direct aid to local boards of education will amount to an estimated $3.7 billion, an increase of $478 million. The projected 14.8 percent growth in direct State aid is considerably higher than the increase of 10.3 percent from fiscal 2004 to 2005. Teachers' retirement costs that the State pays on behalf of local boards of education, however, will increase minimally, from $403 million in fiscal 2005 to an estimated $407 million in fiscal 2006. The 0.9 percent increase in retirement costs would be much lower than the 5.1 percent increase incurred in fiscal 2005.

Bridge to Excellence Drives Funding Increases

More than 90 percent of the projected increase in State education aid, $447 million, can be attributed to growth in the programs established in the Bridge to Excellence in Public Schools Act of 2002 (Bridge to Excellence), which will enter the third year of its phase-in schedule in fiscal 2006. The Bridge to Excellence programs account for 84.8 percent of anticipated aid and 94.1 percent of direct State aid. The phase-in of the Act is scheduled to continue through fiscal 2008, when the Bridge to Excellence formulas will reach full funding. Continued increases of $400 million to $500 million per year are also anticipated for fiscal 2007 and 2008.

Projected fiscal 2006 increases in State education aid programs are displayed in **Exhibit 1**. The largest increase, an estimated $207 million, is in funding for the foundation program. The guaranteed tax base program, which will enter the second year of a four-year phase-in in fiscal 2006, is expected to more than double, from $19 million to $39 million.

Exhibit 1
Estimated State Aid to Education
Fiscal 2006
($ in Millions)

Program	FY 2005	FY 2006	Dollar Change	Percent Change	Percent of FY 2005
Foundation Program	$2,114.6	$2,322.1	$207.5	9.8	56.4
Cost of Education Adjustments	0.0	54.2	54.2	N/A	1.3
Compensatory Education	487.5	598.1	110.6	22.7	14.5
Special Education Formula	157.2	191.7	34.5	21.9	4.7
Limited English Proficiency	51.3	67.0	15.7	30.6	1.6
Guaranteed Tax Base	19.1	38.8	19.7	102.8	0.9
Student Transportation	175.5	185.2	9.7	5.5	4.5
Baltimore City Partnership	21.1	14.1	(7.0)	(33.3)	0.3
Extended Elementary Ed (EEEP)	16.9	19.3	2.4	14.3	0.5
Bridge to Excellence Subtotal	**$3,043.3**	**$3,490.6**	**$447.3**	**14.7**	**84.8**
Teachers' Retirement	$403.2	$406.9	$3.7	0.9	9.9
Nonpublic Special Education	108.8	133.9	25.1	23.1	3.3
Other Programs	78.5	84.5	6.0	7.6	2.1
Total State Education Aid	**$3,633.7**	**$4,115.8**	**$482.1**	**13.3**	**100.0**

Source: Department of Legislative Services

The Bridge to Excellence phase-in demonstrates an emphasis on programs that target aid to school systems with large populations of higher needs students. The special education, limited English proficiency, and compensatory education formulas will increase between 22 and 31 percent each. Combined, an estimated $161 million will be added to these programs in fiscal 2006. Although it is not one of the Bridge to Excellence programs, funding for nonpublic special education placements is also projected to increase by $25 million, or 23.1 percent, in fiscal 2006.

While most Bridge to Excellence funding is being phased in, State aid for the Baltimore City Partnership is being phased out and will be eliminated entirely after fiscal 2006. Funding for the program is scheduled to decrease by $7 million in fiscal 2006, but State aid increases through other formulas will more than cover the reduction in partnership funding for the city.

Unlike the large growth in direct State aid, the increase in teachers' retirement costs (less than $4 million) is unusually low. The State pays retirement costs based on teachers' salaries in the second prior year, so fiscal 2006 retirement costs reflect the fiscal 2004 salary base. Due to budget problems in two of the larger school systems and minimal salary increases in two other large systems, the salary base of teachers increased very modestly in fiscal 2004.

Geographic Cost of Education Funding in Question

The Bridge to Excellence legislation required the foundation program to be adjusted to recognize regional differences in the cost of education that are outside the control of the local jurisdictions. The adjustments were originally scheduled to begin in fiscal 2005, but because the statutory language in the Bridge to Excellence provided no clear formula or amount for the adjustments, funding was not mandated and was not included in the fiscal 2005 budget.

In the 2004 legislative session, the General Assembly established a formula to enhance aid to counties with above average educational resource costs, known as the Geographic Cost of Education Index (GCEI), but did not mandate that the aid be included in the annual State budget. Due to required increases in State spending for education and the ongoing structural budget deficit, it is possible that the $54 million GCEI will not be fully funded in the Governor’s fiscal 2006 budget submission. Without the GCEI, the growth in State education aid would total $428 million, an 11.8 percent increase.

General Assembly to Confront “Trigger” Provision for Second Straight Year

The Bridge to Excellence legislation included a provision that would have limited growth in State education spending to 5 percent per year unless the General Assembly affirmed by joint resolution that the funding increases mandated in the Act were affordable. This “trigger” provision was repealed by House Bill 345 of 2004 on the advice of the Attorney General, who counseled that the provision could be deemed unconstitutional because it does not give the Governor an opportunity to take part in the decision making process (i.e. a legislative veto). A second affordability trigger has been in statute since 1984 that requires the General Assembly to examine State education spending if aid exceeds 31.5 percent of general funds. If a joint resolution affirming the affordability of education aid is not passed, the per pupil foundation level for the next fiscal year is limited to 8 percent growth.

The 31.5 percent threshold was surpassed last fiscal year, but the fiscal 2005 increase in the per pupil foundation amount was only 5.5 percent. Passing a joint resolution, therefore, would have had no impact on mandated State aid. A comparison of education aid and revenue projections for this year indicates that education aid will again exceed 31.5 percent of general funds, and the per pupil foundation level is scheduled to increase by 9.3 percent from $5,039 in fiscal 2005 to $5,495 in fiscal 2006. By law, the General Assembly must pass a joint resolution or the increase in the foundation amount will be reduced to $5,431, an 8 percent increase. If the joint resolution is not passed, projected increases in education aid will decrease by approximately $37 million.

The Attorney General's office has advised that this trigger provision could also be unconstitutional for the same reasons as the Bridge to Excellence trigger. Like last year, the General Assembly could choose to repeal the 31.5 percent trigger early in the legislative session to avoid confusion and possible litigation that could upset the public school funding system. Alternatively, legislation could be crafted to increase the 31.5 percent threshold sufficiently to accommodate the implementation of the Thornton formula, while retaining the 8 percent limitation on growth in the foundation if the threshold is exceeded. Under this scenario, the Governor could be required to fully fund the formulas in the incoming budget, while giving the General Assembly the authority to reduce the budget to the limit. State aid formulas use a uniform per pupil foundation amount to calculate aid for all local school systems, so unlike the alternate funding mandate that was established in the Bridge to Excellence Act and repealed last session, limiting growth in the fiscal 2006 per pupil foundation amount would have a relatively equivalent impact on every school system.

Education

Schools and School Systems More Accountable for Student Performance

Student performance on the Maryland School Assessments and High School Assessments increased significantly across grade levels and subject areas. However, despite improvements, low-income, limited English proficiency, and special education students remain well below the average of all students. Although the number of schools and school systems that failed to meet Adequate Yearly Progress (AYP) decreased dramatically this year, 280 schools, approximately 18 percent of all schools, and nine school systems failed to meet AYP. Five of the nine school systems and approximately half of the schools failed to meet AYP for special education reading or math alone.

Increasing Accountability in Public Schools

One of the main goals of both the Bridge to Excellence in Public Schools Act of 2002 (Bridge to Excellence) and the federal No Child Left Behind Act (NCLB) is to improve academic performance through accountability at all levels: student, school, local school system, and State. Various measurements determine the success or failure at each of these levels. However, certain requirements through which accountability is to be enforced under the Bridge to Excellence and NCLB have yet to take effect, and their consequences remain unclear.

Adequate Yearly Progress

By the 2013-14 school year, NCLB requires that all students in all subgroups (African American, American Indian, Asian/Pacific Islander, Hispanic, White, special education, free and reduced price meals (FRPM), and limited English proficient (LEP)) reach 100 percent proficiency in reading and math. Between now and then, the Maryland State Department of Education (MSDE) has set targets to determine whether each subgroup, school, school system, and the State achieve adequate yearly progress (AYP).

Student Assessments Demonstrate Improvement

The 2003-04 school year marked the first time the Maryland School Assessment (MSA) was administered for grades 3 through 8. While reading and math scores for grades 4, 6, and 7 will not count towards AYP until the 2005-06 school year, scores for grades 3, 5, and 8 are currently used to assess AYP. **Exhibit 1** shows the improvements made in grades 3, 5, and 8 in both reading and math from 2003 to 2004. Students in grade 3 made the biggest improvement in reading from 58.1 percent to 71 percent while students in grade 5 made the greatest gains in math, from 55 percent to 63.1 percent. Dramatic improvement from the prior year in reading and math is also seen among all subgroup categories across the State. However, the performance of FRPM, LEP, and special education students remains significantly below the average of all students, particularly in special education. Many states, including Maryland, have raised serious concerns about achieving the NCLB requirement that special education students meet the same educational standards at the same pace as other students. A task force on NCLB sponsored by the National Conference of State Legislatures is in the process of finalizing recommendations for legislative and regulatory changes on NCLB, and the expectations for special education have been mentioned repeatedly as an area that needs modification.

Exhibit 1
MSA Percent Proficient or Higher

	Reading		Mathematics	
Grade	**2003**	**2004**	**2003**	**2004**
3	58.1%	71.0%	65.1%	72.2%
5	65.7%	68.4%	55.0%	63.1%
8	59.9%	63.8%	39.7%	45.8%

Source: Maryland State Department of Education

Similarly, the results of the High School Assessments (HSA) administered in English, Biology, Government, and Algebra all showed improvement for the 2003-04 school year. In June 2004, the State Board of Education officially made HSA a graduation requirement beginning with the class of 2009 (current eighth graders). Beginning in 2009, in order to receive a high school diploma, students must pass all four HSA or receive a minimum score on each test and earn an overall combined score equal to the sum of the passing scores for each HSA. The latter will allow a student to make up for a low score on one test with a higher score on another test. MSDE has not yet established the minimum scores.

MSDE Reports General Success in Meeting AYP

This year, 280 schools failed to meet AYP targets compared to 473 schools that failed to meet AYP targets last year. According to MSDE, approximately one-half of the schools failed to meet AYP for special education reading or math alone. **Exhibit 2** shows the number of schools in each category of school improvement this year. (Schools that failed to meet AYP for the first time in 2004 will not enter school improvement unless they also fail to meet AYP next year.) If a school labeled in ‘school improvement’ fails to meet AYP for two consecutive years, that school then moves into ‘corrective action.’ If a school in ‘corrective action’ fails to meet AYP the following year, that school is identified for ‘restructuring’ under NCLB. Schools maintain their status if they met AYP this year after failing to meet AYP last year. This year, 53 schools will maintain their status. If a school meets AYP for two years in a row, it exits the school improvement process.

Exhibit 2
Schools in Need of Improvement
Status for 2004-05 School Year

County	School Improvement Year 1	School Improvement Year 2	Corrective Action	Restructuring Plan	Restructuring Implement	Maintain Status**	Total # of Schools in Improvement	Total # of Schools	% of All Schools in Improvement
Allegany	1	1				1	2	26	7.7%
Anne Arundel	11	2		1		3	14	119	11.8%
Baltimore City*	26	2	5	32	39	32	104	183	56.8%
Baltimore	18	1	1			2	20	170	11.8%
Calvert							0	25	
Caroline	1						1	10	10.0%
Carroll							0	42	
Cecil	1						1	31	3.2%
Charles							0	34	
Dorchester	4						4	14	28.6%
Frederick	3	1	1			1	5	58	8.6%
Garrett							0	18	
Harford	5	1				1	6	51	11.8%
Howard	1						1	69	
Kent	1						1	8	12.5%
Montgomery	11	6	1			6	18	194	9.3%
Prince George's	54	3	5	4	7	5	73	204	35.8%
Queen Anne's							0	13	
St. Mary's	2	1				1	3	27	11.1%
Somerset							0	11	
Talbot	1	1				1	2	9	22.2%
Washington							0	46	
Wicomico	1						1	27	3.7%
Worcester							0	14	
Grand Total	**141**	**19**	**13**	**37**	**46**	**53**	**256**	**1403**	**18.2%**

* Includes schools in Edison Partnership.
**Schools maintaining status include schools in school improvement, corrective action, and restructuring that met AYP in 2004 and therefore maintained their status.
Source: Maryland State Department of Education

Exhibit 2 shows that 18.2 percent of schools statewide are in school improvement (*i.e.* failed to meet AYP at least two consecutive years). The majority of schools in school improvement are in Baltimore City and Prince George's County. Prior to NCLB, Maryland utilized a school reconstitution process to identify schools in need of improvement. The vast majority of schools on the reconstitution list were in Baltimore City, and to a much lesser extent, Prince George's County. However, 16 of the 24 school systems have at least one school in improvement, and 11 school systems have more than one school in improvement, indicating that meeting AYP is proving difficult for many school systems in Maryland, not just in Baltimore City and Prince George's County.

Whereas all 24 local school systems failed to meet AYP last year, this year 15 local school systems met AYP targets. Of the nine school systems that failed to meet AYP this year, five school systems missed the target on special education alone. **Exhibit 3** shows the areas in which school systems failed to meet AYP. Baltimore City is currently a school system in corrective action, and the other eight local school systems that did not meet AYP are school systems in school improvement. As a state, Maryland did not meet AYP either this year or last year. Unlike schools and school systems, however, there are no consequences for the State's failure to achieve AYP targets.

Exhibit 3
Schools Systems Failing to Meet AYP Target

African American Math and Reading	Special Education Math and Reading	FRPM Math and Reading	LEP Math and Reading
Dorchester	Allegany	Dorchester	Baltimore City[1]
Kent	Baltimore City[1]	Prince George's[3]	
	Cecil		
	Charles		
	Dorchester		
	Prince George's		
	Somerset		
	St. Mary's[2]		

[1] Baltimore City also failed to meet AYP target for attendance and graduation.
[2] Failed to meet target for reading only.
[3] Failed to meet target for math only.

Note: FRPM – free and reduced price meals.
LEP – limited English proficient.

Source: Maryland State Department of Education

Special Education Teachers and the 'Highly Qualified' Requirement

Meeting AYP is only one of NCLB requirements that is proving difficult to achieve. In order to meet the NCLB requirement of having a highly qualified teacher (HQT) in every classroom by the 2005-06 school year, MSDE has set intermediate goals. Last year the State average was at 64.5 percent of the 100 percent goal. For the 2003-04 school year, the State averaged 67 percent, slightly exceeding its intermediate goal of 65 percent. Different school systems are further from the goal than others. However, county-level HQT data is not yet available from MSDE. Looking at the percentage of teachers with conditional certification in each county suggests that several counties, including Baltimore City (23.1percent), Prince George's (16.4 percent), and Charles (10.5 percent), may have a difficult time meeting the HQT requirement next year.

For the 2004-05 school year, MSDE anticipates reaching its goal of 75 percent; however, in order to meet this goal MSDE reports that some modifications need to be made to the highly objective uniform State standard of evaluation (HOUSSE) for veteran special education teachers. Special education is not a core academic subject in which a teacher can demonstrate proficiency through HOUSSE. Often, special education teachers are responsible for the instruction of multiple core academic subjects. Therefore, the revised HOUSSE for special education teachers affords the designation of HQT to a veteran special education teacher who holds a specified Standard or Advanced Professional Certificate in combination with completed course work in reading and content specific core subject areas being taught, years of experience, continuing professional development, and various activities relating to the core academic subjects. This modification should assist school systems in achieving the HQT requirement.

The Label of a "Persistently Dangerous" School

NCLB requires that the states develop a method to identify schools with a high incidence of violence so that students in these schools may transfer to a 'safe' school. MSDE labels a school as 'persistently dangerous' after school suspensions (exceeding 10 days) or expulsions equal or exceed 2.5 percent of the school's student population for three consecutive years. Offenses for which these suspensions or expulsions are considered include arson or fire, drugs, explosives, firearms, other weapons, and physical attacks on students or school personnel.

Although Prince George's County and Baltimore City have schools which meet the suspension and expulsion criteria, only Baltimore City has schools which meet the criteria for the second consecutive year. These Baltimore City Schools could be identified as persistently dangerous if they meet the criteria again in the 2004-05 school year. Of these 15 schools in Baltimore City, 2 have been disrupted in the last six months by student-set fires, 1 was the scene of a shooting of two teenagers, and 1 was the scene of a brawl that ended in the use of pepper spray by the police. Some principals and teachers in Baltimore City have complained that they have been pressured not to remove disruptive students in an attempt to avoid being labeled 'persistently dangerous' for a third consecutive year. But the Chief Executive Officer of the

Baltimore City School System denies this allegation and insists that the administration's interest is in suspending or expelling students who commit violent offenses.

Education

School System Fiscal Accountability

In response to budget deficits in two school systems and the significant State funding of public education, the General Assembly passed the Education Fiscal Accountability and Oversight Act of 2004 (Chapter 148) to increase the fiscal accountability of school systems. Local school systems are prohibited from having a general fund deficit, with consequences for school systems that fail to comply with the law. In addition, a legislative audit of each school system's financial management practices will be conducted over the next six years to improve the efficiency and effectiveness of school systems' administrative functions. Finally, the Bridge to Excellence master plan updates were modified by Chapter 148 to require school systems to report on the alignment between expenditures and the master plan's goals and strategies. The State Department of Education will submit the results of a budget review of school systems in December 2004, and the Department of Legislative Services will prepare an analysis of school system expenditures for the 2005 session.

State Enhances Fiscal Accountability for $3.6 Billion in Education Aid

As the Bridge to Excellence in Public Education Act of 2002 (Chapter 288) phases in over the next three years, State funding for public schools will increase significantly. Local education agencies (LEAs) will receive $3.6 billion in State education aid in fiscal 2005. From fiscal 2005 to 2008, State education aid will increase by 9.4 percent annually. By fiscal 2008, State education aid will account for 36 percent of general fund expenditures, compared to 26 percent of general fund expenditures in fiscal 2002. In response to this significant increase in State education aid and reported budget deficits in two school systems, Baltimore City and Prince George's County, the General Assembly passed legislation during the 2004 session to enhance the fiscal accountability of LEAs.

The Education Fiscal Accountability and Oversight Act of 2004 (Chapter 148) prohibits LEAs from carrying a general fund budget deficit as reported in the annual independent audit. If an LEA has a deficit, the State Superintendent of Schools must immediately notify the Governor, the General Assembly, the Department of Legislative Services, and the county governing body and require the LEA to (1) develop and submit for approval a corrective action cost containment plan within 15 days, (2) file monthly status reports with the State Superintendent and county governing body demonstrating actions taken to close the deficit and the effect of the actions taken on the deficit, and (3) include information on the corrective action cost containment plan, actions taken to close the deficit, and status of the deficit in the biannual financial status reports filed with the State Superintendent and county governing body. The State Superintendent must include this information in a quarterly report submitted to the Governor and the General Assembly. If an LEA fails to comply with the specified requirements, the State Superintendent, with the approval of the State Board of Education, must then withhold 10 percent of the next installment and each subsequent installment due to the LEAs from the General State School Fund until the LEA is in full compliance. LEAs are also required to submit biannual financial status reports to the State Superintendent.

The fiscal 2004 annual audit reports of LEAs were due to the State on September 30, 2004. Of the 23 reports that have been received by the Maryland State Department of Education (MSDE), the Baltimore City Public School System (BCPSS) is the only one to report a general fund deficit. BCPSS has submitted a corrective action plan, as required by the law, and the monthly status reports are due by the twentieth of each month. (See "Court Orders Additional Funding for Baltimore City Schools in Wake of Budget Reductions to Eliminate Deficit" issue paper for a full discussion of BCPSS fiscal status.) The Prince George's County Public Schools (PGCPS) has submitted a draft audit report, but as of November 19, 2004, the final report has not been submitted. Based on the preliminary figures, PGCPS does not have a general fund deficit in fiscal 2004, compared to a reported $23.7 million deficit at the end of fiscal 2003. PGCPS continues to have deficits, totaling $25.4 million, in several special funds (excluding the capital projects fund). Although Chapter 148 prohibits a general fund deficit, MSDE requires LEAs to explain deficits in both the general and special funds. This information is not yet available for PGCPS.

Legislative Audits of LEA Financial Management Practices and Master Plans Required

Chapter 148 establishes a legislative audit requirement for LEAs. Over the next six years, the Office of Legislative Audits (OLA) will conduct an audit of each LEA to evaluate the effectiveness and efficiency of the financial management practices. LEAs with a negative general fund balance of 1 percent or more in either of the prior two fiscal years must be included in the first group of audits. Thereafter, OLA must give priority to any LEA that fails to comply with the requirements of Chapter 148.

As required by the law, the scope, measurements, and process to be used by OLA in the audits were approved by the Joint Audit Committee in September 2004. OLA began the audits of BCPSS and PGCPS in November 2004. The field work is expected to be completed in the spring of 2005, and the first audit reports will be finalized later in the year. OLA anticipates beginning a third LEAs audit in early 2005. OLA is establishing an audit schedule to allow for a combination of large and small LEAs to be audited each year. To assist OLA in conducting the 24 new audits over a six-year period, the General Assembly appropriated funds for nine additional audit positions in fiscal 2005.

In addition, Chapter 148 required OLA to conduct a centralized performance audit of the comprehensive master plans and updates submitted by LEAs for compliance with the Bridge to Excellence requirements. Originally due by December 1, 2004, at the request of OLA, the General Assembly extended the deadline to January 14, 2005.

Changes Made to Master Plan Update Requirements

Chapter 148 also modified the requirements for the annual master plan updates originally enacted under the Bridge to Excellence. The master plan updates are now required to include information on how LEA expenditures align with the master plan and updates. The master plan submission deadline was extended to August 15, in order to collect more data, and budgetary information on how the budgeted increase in expenditures in the upcoming fiscal year is consistent with the master plan must be included. By October 1 of each year, LEAs must submit information on how increases in actual expenditures over the prior year are consistent with the master plan. MSDE must annually review how each LEA's current year and prior year budgets align with the master plan and updates. By December 1, MSDE must report the results of the budget review to the Governor, General Assembly, and local officials. The Department of Legislative Services will prepare an analysis during the 2005 legislative session of how LEAs are spending their funds in comparison to other LEAs as well as how they align with the master plans.

Master Plan Updates Submitted for Approval

In reviewing the master plan updates for approval this year, MSDE used a peer review system similar to the review process for the original master plan submissions. LEAs were required to submit written responses to specific questions regarding the implementation of their master plans. For example, what aspects of your master plan are/are not producing the intended results? As a result of your annual review of student and school progress, what refinements or changes are you making to your master plan at this time?

Several school systems, particularly the smaller school systems, faced the challenge of providing adequate services to students despite a shortage in administrative and teaching staff. Other school systems had difficulty in retaining and recruiting teachers which hampered the development of the master plan. The challenge of aligning a local school system budget with the goals of the master plan was also expressed during the review sessions.

The review of master plan updates was completed in September 2004. The State Board of Education approved 21 of 23 updates. (Baltimore City did not submit an update as its master plan had not yet been approved.) Neither Prince George's County nor Somerset County received approval based on a failure to make adequate adjustments in certain areas. Both of these school systems are labeled as in 'school improvement' under No Child Left Behind. (See "Significant Education Funding Increases Scheduled for Third Year of Bridge to Excellence Phase-in" for further discussion.) Each LEA will resubmit its master plan update to MSDE in November and reconsideration of approval will take place in December.

BCPSS' Master Plan Finally Approved

On October 27, 2004, the State Board of Education approved a revised Master Plan II of BCPSS. This approval comes after two previous master plan submissions were not approved due to an incomplete plan. The State board's approval comes with a requirement that the Chief Executive Officer report each month on the ability of BCPSS to implement and carry out the goals, objectives, and strategies detailed in the plan and the congruence of the restructuring plans and corrective action plans of the 15 schools on probationary status under the Unsafe Schools Choice Option, six of which are implementing a restructuring plan.

Education

Court Orders Additional Funding for Baltimore City Schools in Wake of Budget Reductions to Eliminate Deficit

The fiscal 2004 audit of the Baltimore City Public School System (BCPSS) shows that budget reduction efforts were successful in not adding to the $58.1 million deficit revealed before the 2004 session. BCPSS adopted a financial recovery plan this summer that makes further budget reductions and other actions in order to eliminate the deficit by the end of fiscal 2006. In response to the financial plan, the American Civil Liberties Union (ACLU) filed suit in Baltimore City Circuit Court asserting that students were being denied their constitutional right to a "thorough and efficient" education. The court ruled in favor of ACLU and ordered the State or City to provide an additional $30-45 million to BCPSS in fiscal 2005. The State Board of Education has appealed the ruling. In addition, BCPSS Board of School Commissioners recently approved 10 charter schools for the next academic year, the first charter schools in the State under the Public Charter School Act of 2003.

Budget Problems Continually in the Spotlight in Fiscal 2004

Mounting budget problems for the Baltimore City Public School System (BCPSS) became public more than a year ago when the system was forced to lay off approximately 800 employees in November and December 2003. The fiscal 2003 audit, released November 7, 2003, reported that the school system's deficit had increased by $35.9 million during the fiscal year to close at $58.1 million. Further documentation from BCPSS indicated that the system was on pace to increase the deficit beyond $75 million by the end of fiscal 2004 without the spending reductions that were adopted.

In addition, a separate but related cash flow problem was announced by BCPSS during the 2004 legislative session. Although a State legislative solution was discussed, fiscal relief was instead provided by the Baltimore City government. In May 2004, BCPSS and Baltimore City entered a Memorandum of Understanding (MOU) under which the city provided a short-term $42 million loan to alleviate the school system's cash flow crunch and the school system submitted to heightened fiscal supervision by the city. The MOU required that the $58 million deficit be eliminated by the end of fiscal 2006, a requirement also imposed by the State in the Education Fiscal Accountability and Oversight Act of 2004 (Chapter 148). BCPSS repaid $34 million to Baltimore City in August 2004, and the remaining $8 million is due by the end of fiscal 2006.

Latest Audit Shows that Deficit Did Not Increase in Fiscal 2004

The fiscal 2004 audit of BCPSS finances, released October 29, 2004, reveals that the budget reduction efforts were effective in avoiding any further accumulation of the deficit. As shown in **Exhibit 1**, audited revenues declined from $900 million in fiscal 2003 to $883 million in fiscal 2004, while expenditures dropped from $935 million to $883 million. The reason for the $16.6 million dip in revenues is unclear but most likely involves a substantial decrease in federal revenues in fiscal 2004 and inconsistent approaches to booking State aid revenues over the two years. Regardless, the results of the spending reductions made during the fiscal year are clearly shown in the audit figures, which reveal a $53 million decrease in expenditures from fiscal 2003 to 2004.

Exhibit 1
Baltimore City Public School System Finances
Fiscal 2003-05

	Audited FY 2003	Audited FY 2004	Budgeted FY 2005
Revenues	$899.6	$883.0	$944.3
Expenditures			
Contingency Fund	$0.0	$0.0	$10.0
Deficit Pay-down	0.0	0.0	35.0
Education Program	935.4	882.6	899.3
Total	$935.4	$882.6	$944.3
Year Balance	($35.9)	$0.4	$35.0
Beginning Balance	(22.2)	(58.1)	(57.7)
Ending Balance	($58.1)	($57.7)	($22.7)

Note: General and special funds are shown in the chart; capital and debt service funds are excluded. Revenue and expenditure figures do not include funding for Edison Schools or teachers' retirement payments.

Source: Fiscal 2003 and 2004 Independent Auditor's Reports and fiscal 2005 Proposed Operating Budget for BCPSS

According to the fiscal 2005 BCPSS operating budget, revenues are expected to rebound in the current school year to an estimated $944 million. However, with the need to reduce the ongoing deficit, provide for a contingency fund, and ensure a stable cash flow throughout the fiscal year, expenditures for the education program are still budgeted at $36 million below the fiscal 2003 level.

In addition to programmatic spending, a contingency fund of $10 million is included in the fiscal 2005 BCPSS budget, and $35 million will be reserved to pay a portion of the deficit. These features are part of a BCPSS financial recovery plan prepared in consultation with representatives of Baltimore City. The recovery plan also identifies several budget reductions, including annualization of fiscal 2004 cuts made to central office staff and to high school and middle school programming, a class size increase of two students per classroom, elimination of summer school, and a reduction in transportation costs.

Fiscal 2005 Budget Reductions Prompt Court to Revisit the *Bradford* Case

The financial recovery plan caught the attention of the American Civil Liberties Union (ACLU), which has represented BCPSS students in the case of *Bradford, et. al. v. Maryland State Board of Education, et al.* since 1994. The ACLU filed a motion in the Circuit Court for Baltimore City arguing that the constitutional violation previously established by the court continues to exist and that the actions taken to address the fiscal crisis reduce educational opportunities for BCPSS students. The plaintiffs asked the court for a declaration "directing the State, [Baltimore] City and Board [of School Commissioners of Baltimore City] to revisit their plans to address the fiscal crisis" to ensure funds are sufficient to continue progress towards providing an adequate education.

Despite opposition to the motion from the State and Baltimore City, the court issued an order after four days of hearings that found that BCPSS students are still being denied a "thorough and efficient" education pursuant to findings by the court in 1996 and 2000, and that certain reductions made to address the system's fiscal crisis "impermissibly interfere with progress toward providing a constitutionally adequate education for Baltimore schoolchildren." The ruling declares that an amount equivalent to the reductions should be restored to the school system in fiscal 2005 and that the best way to accomplish this would be for the State or city to increase the funding available to BCPSS by $30 to $45 million.

The circuit court's ruling also invalidated as unconstitutional the requirement in the Education Fiscal Accountability and Oversight Act of 2004 that requires BCPSS to eliminate the deficit by the end of fiscal 2006. The court prohibited the retirement of the deficit prior to fiscal 2008 and the appropriation of more than $5 million per year for a BCPSS contingency fund unless additional State funds are provided. Although the court nullified certain parts of the MOU, the scheduled repayment of the $42 million advanced by Baltimore City was allowed to stand. The State Board of Education has appealed the circuit court's decision.

Baltimore City School Board First in State to Approve Charter Schools

Despite ongoing budget questions, the Baltimore City Board of School Commissioners gave initial approval to the formation of three new charter schools in November 2004, making it the first local board to approve the schools under the Public Charter School Act of 2003 (Chapter

358). The three schools are expected to open in the city in fall 2005, and seven existing schools that have been operating independently under a 1997 New Schools Initiative will also be awarded charters. A question that remains unanswered at this point is how much funding the charter schools will receive. As required by the Act, the Baltimore City Board of School Commissioners must pay a charter school an amount of local, State, and federal funding that is commensurate with the amounts paid to other BCPSS schools. Given the recent budget problems in Baltimore City, some board members have expressed concerns about financing charter schools.

Education

Public School Facilities Act Sets Ambitious State Goal of $2 Billion to Bring Schools Up to 2003 Standards by Fiscal 2013

The Public School Facilities Act of 2004 set a goal to fully fund school construction projects by fiscal 2013 to meet minimum required standards for new construction as of July 2003. Based on the work of the Task Force to Study Public School Facilities, the total cost to meet standards is estimated at $3.85 billion with the State's share at approximately $2 billion and local governments' share at $1.85 billion. Increasing the debt authorization by $150 million annually, in addition to the $100 million annually the State has already committed, for eight years would allow the State to meet the goal by fiscal 2013. Although the Capital Debt Affordability Committee concluded that authorizing the additional $1.2 billion in debt meets current affordability criteria, the committee recommended that other options, including alternative financing mechanisms, new revenue streams, and shifting other capital projects, should be fully explored before increasing the bond authorization.

Cost of Authorizing Additional School Construction Debt Is Substantial

Chapters 306 and 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 for new construction as of July 2003. The Act was a response to the November 2003 survey results of the Task Force to Study Public School Facilities. The task force concluded that many Maryland public schools were deficient in some capacity and that the cost to bring schools up to the 2003 standard would be $3.85 billion. **Exhibit 1** shows the total cost of bringing schools up to standard by school system in 2004 dollars. Through the State/local shared cost formula, the State would provide $2 billion of the $3.85 billion over the next eight fiscal years, with the remaining share funded by local governments.

The State has currently committed to $800 million ($100 million annually) in the Department of Budget and Management's (DBM) Capital Improvement Program (CIP), leaving a $1.2 billion shortfall. Increasing the debt authorization by $150 million annually for eight years would allow the State to meet the goal in fiscal 2013. While the State could meet the goal by increasing the debt authorization, and it would be affordable under the State's debt affordability criteria, increasing the debt authorization by $1.2 billion would increase debt service costs above the amount planned for the out-year budgets and could limit the State's ability to issue debt for other programs, such as transportation. Increasing the debt authorization by $1.2 billion is projected to cost over $1.8 billion. Based on data from recent public school construction authorizations, authorized funds would not be spent immediately. Instead, the program would need to be phased in over a number of years. If authorizations are increased in the 2005 session, the first debt service payment is projected to be $3.8 million in fiscal 2007. As the program progresses, debt service costs increase to over $100 million annually in 10 years, peaking at over $130 million annually in 2018.

Exhibit 1

Cost Estimates to Bring Facilities Up to Current Standards for New Construction*

($ in Thousands)

School System	Estimated Cost
Allegany	$71,426
Anne Arundel	336,458
Baltimore City	570,599
Baltimore County	408,845
Calvert	102,911
Caroline	5,435
Carroll	135,297
Cecil	46,873
Charles	178,419
Dorchester	33,816
Frederick	203,625
Garrett	20,142
Harford	204,666
Howard	168,727
Kent	1,180
Montgomery	279,307
Prince George's	778,225
Queen Anne's	9,666
St. Mary's	52,530
Somerset	9,030
Talbot	18,989
Washington	93,827
Wicomico	69,993
Worcester	54,122
Total State and Local Cost	**$3,854,108**

*Costs reported by local school systems in July 2004 dollars.

Source: Public School Construction Program

Additional Debt Meets Current CDAC Affordability Criteria

The Capital Debt Affordability Committee (CDAC) was required by Chapters 306 and 307 to review the school construction needs and make a funding recommendation annually. The committee recommended to the 2005 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 an action 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 concluded that other funding methods, such as alternative financing mechanisms, new revenue streams, and shifting other capital projects in the CIP, should be fully explored before increasing the bond authorization.

Based on current projections and affordability standards, issuing additional general obligation (GO) debt to support the public school construction program is affordable. The controlling criterion for affordability is debt outstanding to personal income. **Exhibit 2** shows that debt outstanding remains under 3.2 percent of personal income. The State still has over $1 billion in unused debt capacity over the next five years. This unused capacity declines in fiscal 2009 and is likely to continue declining as the proposed expansion is phased in over the next decade. Similarly, debt service remains under 8 percent of revenues, consistent with the CDAC debt service criterion. Debt service would be 6.18 percent of revenues in fiscal 2010 compared to 6 percent without the additional school construction debt.

Exhibit 2

Effect of Authorizing Additional GO Bonds for Public School Construction

Debt Outstanding to Personal Income Ratio Remains Under 3.2 Percent

Fiscal Year	Current Proposal	With Additional Public School Debt	Difference	Remaining Capacity ($ in Millions)
2006	2.73%	2.75%	0.02%	1,105
2007	2.68	2.73	0.05	1,212
2008	2.65	2.74	0.09	1,231
2009	2.67	2.81	0.13	1,113
2010	2.69	2.86	0.17	1,014

Source: Department of Legislative Services

CDAC Does Not Recommend Authorizing Additional Debt

The CDAC expressed concerns about the magnitude of this proposed expansion and instead of recommending that the GO bond program be expanded, the committee recommended that the State first examine:

- ***Alternative financing sources:*** Chapters 306 and 307 authorize the use of alternative financing methods, such as leasing arrangements with contractors and other public-private partnerships. The Interagency Committee on School Construction (IAC) advises that the regulations pertaining to these new laws are being promulgated and should be implemented by the end of fiscal 2005. The IAC is also monitoring these financing methods to determine which can be applied more broadly across the State.

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

- ***Shifting funds from other projects:*** The current capital request exceeds available funding. Each year DBM prepares a CIP, which identifies capital projects to be funded. The CIP funding levels are generally consistent with the CDAC proposed authorizations. To provide additional funding for public school construction would require the State to delay or eliminate other projects in the CIP. The Department of Legislative Services (DLS) will examine the implications of reducing the current capital program to fund more public school construction when the Governor's capital budget is submitted at the beginning of the 2005 legislative session.

Concerns about Expanding the GO Program

While the debt is affordable based on CDAC criteria, DLS has the following concerns about expanding GO bond authorizations:

- ***Current revenues are insufficient to fund debt service in the out-years, and expanding the capital program exacerbates the revenue shortfall:*** Current property tax rates are insufficient to fully fund debt service for current projects. An unusually high Annuity Bond Fund balance is providing the additional funds necessary. It is projected that the fund balance will be depleted by fiscal 2008, and the State will either need to raise State property tax rates or appropriate general funds. DLS estimates that the State property tax will need to be raised by $0.014 per $100 of assessable base to support current debt service in fiscal 2010. Implementing this proposed GO debt expansion for public school construction requires the State to increase its property taxes by $0.022 per $100 of assessable base.

- ***Issuing additional debt limits capacity for non-GO bond financed projects:*** The proposed increase in school construction debt absorbs one-third of projected debt capacity in fiscal 2010. The GO bond program is part of the State's debt program. Other components include transportation, bay restoration bonds, stadium authority bonds, and capital leases. Increasing GO debt limits how much the other programs can issue.

- ***Local ability to fund and manage the proposed expansion:*** The proposed expansion requires that local jurisdictions provide $1.85 billion to support funding. This may be more than some jurisdictions are willing or able to fund.

- ***Short term ability of the market to absorb the additional work:*** The capacity to build and renovate schools is limited. This proposed expansion represents a major commitment. At times it may be difficult for the construction market to meet all the new demand. This could result in higher costs and, if the work is too rushed or inferior contractors enter the market, lower quality.

New State/Local Shared Cost Formula for Fiscal 2006

In addition to establishing a State funding goal and authorizing alternative funding mechanisms, Chapters 306 and 307 made several other changes to the State Public School Construction Program. A new State/local shared cost formula is established by the law, effective beginning in fiscal 2006. The formula recommended by the task force, which included new components to recognize the proportion of low-income students, enrollment growth, economically distressed counties, and local funding effort by counties, was enacted with a few modifications. The law required the local effort component of the formula to include PAYGO funding provided by local governments for school construction. In addition, the law provided a hold harmless provision so that in fiscal 2006 through 2008, no county will receive a State share that is less than the county's State share in fiscal 2005. **Exhibit 3** shows the new cost share formula and the previous formula. Under Chapter 306 and 307, the formula will be updated every three years.

The law also mandated $1 million in State funding for relocatable classrooms in each of the next three years, beginning in fiscal 2006. Previously, relocatable classrooms were considered a local cost, and no State funds were provided for local school systems to purchase relocatable classrooms. The task force concluded that implementing full-day kindergarten for all students by the 2007-08 school year, as required by the Bridge to Excellence in Public Schools Act of 2002, in combination with existing capacity issues in many counties revealed by the survey results, required the State to provide temporary, limited funding to assist locals in purchasing relocatable classrooms to meet short-term capacity needs. In addition, the law requires the Board of Public Works to adopt regulations by July 1, 2005, implementing numerous provisions of the new law, including reducing the State rated classroom capacity for grades 1 through 5 to 23 students per classroom.

Exhibit 3

Comparison of Fiscal 2006-08 State Share to Fiscal 2005 State Share for School Construction

County	FY 2005 State Share	FY 2006-08 State Share	Difference
Allegany	75%	90%	15%
Anne Arundel	50	50	0
Baltimore City	90/75	97	*
Baltimore	50	50	0
Calvert	55	69	14
Caroline	75	89	14
Carroll	65	65	0
Cecil	70	70	0
Charles	65	70	5
Dorchester	70	77	7
Frederick	65	72	7
Garrett	70	70	0
Harford	65	65	0
Howard	50	58	8
Kent	50	50	0
Montgomery	50	50	0
Prince George's	75/65/60	75/69	**
Queen Anne's	55	70	15
St. Mary's	70	72	2
Somerset	80	97	17
Talbot	50	50	0
Washington	65	65	0
Wicomico	70	81	11
Worcester	50	50	0

*For fiscal 2002-05, the State provided 90 percent of Baltimore City's eligible costs for the first $20 million, and for funding above $20 million the State provided 75 percent of eligible costs. For fiscal 2006-08, the State will provide 97 percent of eligible costs.

**For fiscal 1999-05, the State provided 75 percent of Prince George's County's eligible costs for the first $35 million, and for funding above $35 million the State provided 60 percent (fiscal 1999-03) or 65 percent (fiscal 2003-04) of eligible costs. For fiscal 2006-08, the State will provide 75 percent of eligible costs for the first $35 million, and for funding above $35 million, 69 percent of eligible costs.

Source: Public School Construction Program and Department of Legislative Services

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Higher Education

Enrollment Growth Will Continue but at Much Slower Rates; Effect on Building Needs Unclear

Higher education enrollment is expected to outpace college-age population growth in the next 10 years. However, within every segment of higher education, the average annual growth rates are expected to be lower than they have been over the past four years. The link between enrollment growth and physical space requirements is unclear. In addition, the effect of online education and the K-12 Thornton investment on enrollment projections are unknown. The University System of Maryland has changed its enrollment projection model to one that generates higher projections than in the past, but the State's official projection model, produced by the Maryland Higher Education Commission, has not changed.

Discussions of burgeoning enrollment in higher education are prompting questions about whether Maryland institutions have adequate capacity. Higher education enrollment is projected to increase in the coming years, but with current information, it is unclear how this translates into building needs to accommodate additional students.

Continuing a recent trend, the most dramatic enrollment growth is expected at the University of Maryland University College (UMUC). Since fiscal 1996, community colleges have grown faster than four-year public institutions, not including UMUC, but projections expect this trend to be reversed. Within every segment of higher education, average annual growth rates are estimated to be lower in the next 10 years than they have been over the past four years (since fiscal 2000).

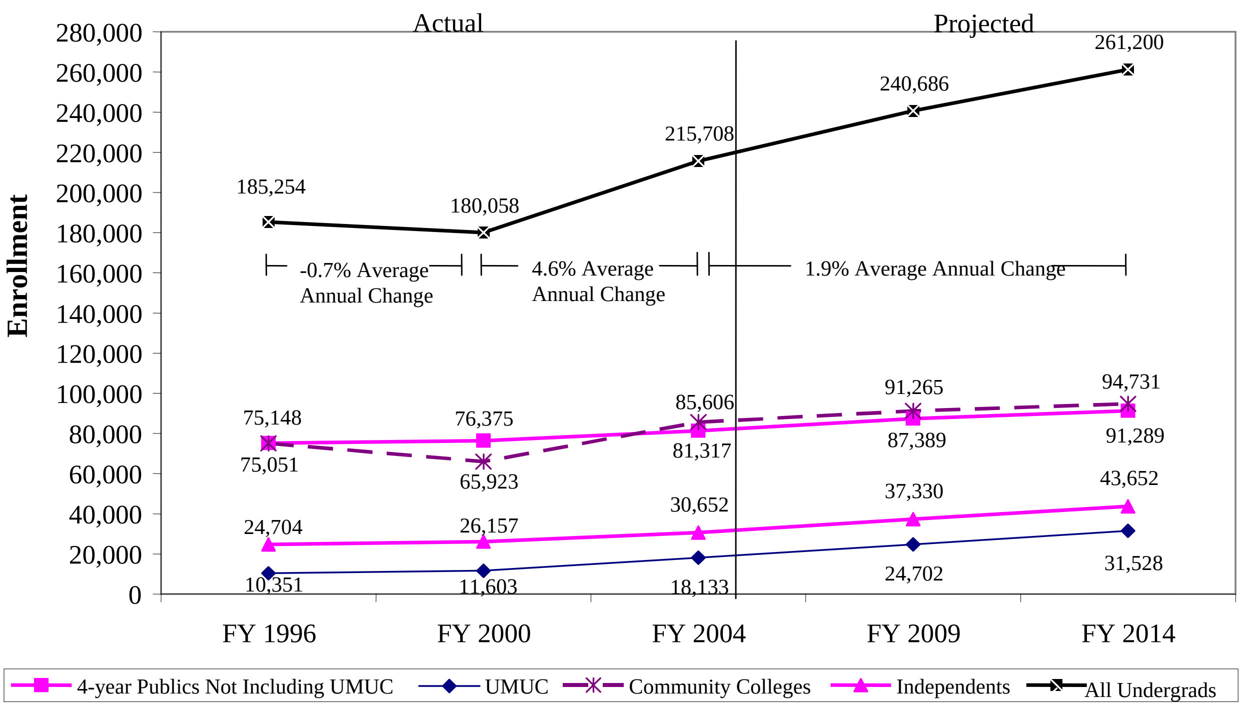
Projected Growth Rates Vary Among Institutions but Outpace Population

Higher education enrollments are driven by the size of the traditional college-age population, or those aged 18 to 24. This population is expected to grow – and slightly increase its share of total population – in Maryland and across the United States in the coming years. Census Bureau projections indicate that Maryland's college-age population will grow by 8.5 percent from 2005 to 2015.

Higher education enrollment growth in Maryland is expected to outpace the college-age population growth rate over the next 10 years. The Maryland Higher Education Commission (MHEC) projects that public higher education headcount enrollment – including graduate students and community college students – will increase 22.8 percent from fiscal 2004 to 2014.

Undergraduate headcount enrollment is projected to increase 21.1 percent to top more than 260,000 in 2014, as shown in **Exhibit 1**. The undergraduate number includes public four-year institutions' undergraduates, community college students pursuing associate's degrees, and undergraduates at Maryland independent institutions. Undergraduate enrollment actually decreased slightly from 1996 to 2000, driven by a decline at community colleges, but rose significantly in the past four years. Enrollment is expected to grow modestly over the next 10 years.

Exhibit 1
Undergraduate Headcount Enrollment



Note: Total undergraduate enrollment includes undergraduates at public four-year institutions, community college students pursuing associate's degrees, and undergraduates at Maryland independent institutions.

Source: Maryland State Department of Education, Maryland Higher Education Commission, Department of Legislative Services

Enrollment growth rates are expected to vary among different types of institutions. However, within every segment of higher education, average annual growth rates are projected to be lower in the next 10 years than they have been since fiscal 2000. Exhibit 1 shows the overall picture. The last few years of growth likely have seemed particularly dramatic because they coincided with reductions in general funds for higher education.

From 2004 to 2014, UMUC is expected to experience the highest growth rate at 73.9 percent. Independent institutions are expected to grow 42.4 percent. The TESST College of Technology, a two-year college, is driving growth among independent institutions.

Four-year public institutions, not including UMUC, have the next highest expected growth rate at 11.5 percent, followed closely by community colleges at 10.7 percent. These projections reverse the recent trend in growth rates between four-year institutions and community colleges. From fiscal 1996 to 2004, community colleges grew 14.1 percent, followed by four-year public schools not including UMUC at 8.2 percent. Community college enrollment actually fell between fiscal 1996 and 2000 but since has increased dramatically; in fiscal 2003 the number of students finally regained the level from 1996. Also in fiscal 2003, the total number of community college students exceeded the total at public four-year institutions besides UMUC for the first time since 1996.

Undergraduate Enrollment Pattern Different Than High School Graduate Trend

Further review of historic enrollment data for undergraduates and high school graduates helps set a context for the projections discussed above. Since the 1970s, enrollment in higher education has increased across the country. The increase has been spurred by growth in the traditional college-age population as well as an increasing proportion of high school graduates who go to college.

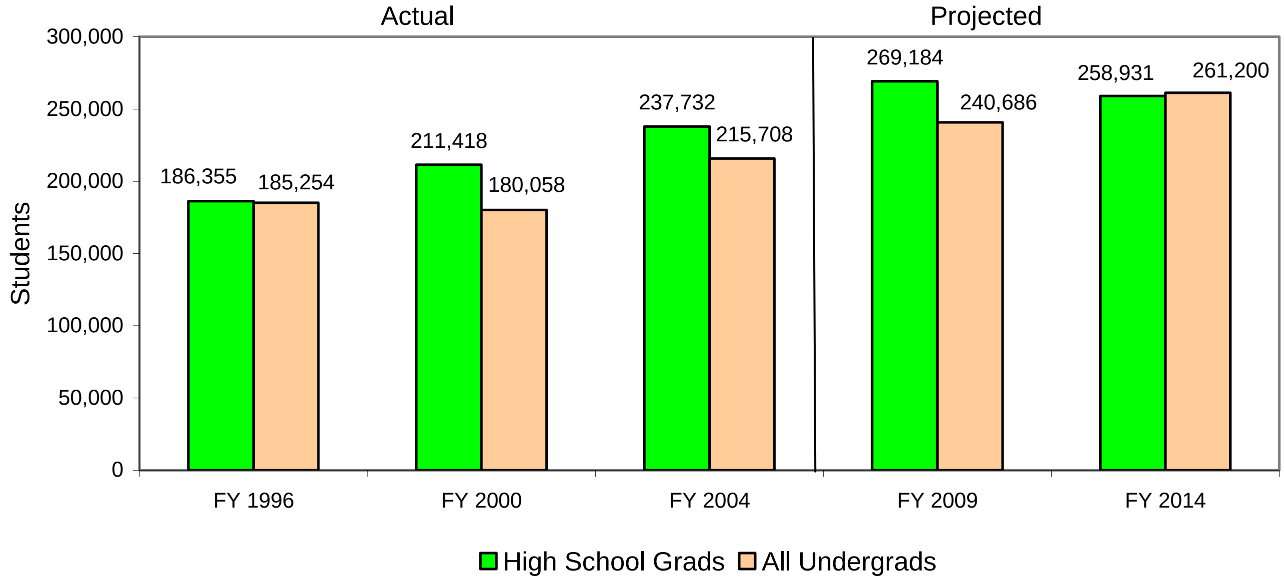
Maryland's experience shows that enrollment growth can outstrip college-age population growth. The State's 18- to 24-year old population declined 18 percent from 1980 to 2000. However, enrollment at four-year public higher education institutions increased 16 percent during this time. The trend was helped by an increasing college going rate (it rose about 4 percent in the 1990s) and a growing number of students graduating from high school.

Although the numbers of high school graduates and undergraduates have enjoyed an overall upward trend, their growth patterns differ, as shown in **Exhibit 2**. The exhibit reflects four-year cohorts of high school graduates so they can be compared to freshmen through senior undergraduates at one point in time.

High school graduates have steadily increased since at least fiscal 1996, and they are expected to continue their climb until fiscal 2010 and then decline. In contrast, undergraduate enrollments dropped from fiscal 1996 to 2000 but then increased through 2004. The gap between high school graduates and undergraduates is expected to widen by 2009, but by fiscal 2014 they are expected to be nearly even again, as they were in 1996.

One trend working to narrow the gap is that the undergraduate enrollment growth rate has outpaced the high school graduate growth rate since fiscal 2000. A tendency that widens the gap is that Maryland usually is a net exporter of high school graduates going to college, meaning more students leave the State than enter it to attend college. The undergraduate data in the exhibits includes in-state and out-of-state students.

Exhibit 2
High School Graduates and Undergraduate Headcount Enrollment



Note: Undergraduate enrollment includes undergraduates at public four-year institutions, community college students pursuing associate's degrees, and undergraduates at Maryland independent institutions.

Source: Maryland State Department of Education, Maryland Higher Education Commission, Department of Legislative Services

USM Changes Its Projection Method; Effect of Thornton Unknown

USM has decided to change its enrollment projections from a model of what is likely to happen – given budget constraints – to a model of what could happen, also referred to as a demand model. The demand model is based on age and race demographics in different Maryland regions, as well as each institution's past enrollment. The demand model serves as the basis for the November 2003 report submitted by the University System of Maryland (USM), the Maryland Association of Community Colleges, and MHEC in response to a *Joint Chairmen's Report* request to study the State's ability to provide higher education. The demand model generates higher numbers than the MHEC model; through 2011, the demand model projects a 31 percent increase in higher education headcount enrollment while the MHEC model projects a 22 percent increase.

A great unknown in projections of Maryland's higher education enrollment is the effect of "Thornton," the State's investment in K-12 education to improve student performance and college readiness. The effect of other states' significant investment in K-12 education is vague. Over time it is likely that the college-going rate in Maryland will increase, consistent with its rise over the past eight years, but how much more it might increase as a result of Thornton cannot now be estimated. At this point MHEC is not using special factors to account for a Thornton-induced enrollment increase.

Unclear Link between USM Enrollment and Physical Space Requirements

Higher education enrollment is expected to increase in the coming years, but with current information, it is unclear how this translates into building needs to accommodate additional students. Enrollment may not be the only factor – or even the primary factor – motivating capital projects.

A USM analysis indicates that faculty, rather than physical space, is the most significant constraint on enrollment growth. In other words, if additional enrollment were to be served by existing resources, faculty availability to teach courses would be exhausted first. USM says this holds even with accommodations for increased faculty workload and additional course offerings on Fridays. Student support services are another constraint generally not tied to space requirements. Housing, on the other hand, is a space-related constraint because growth is directed to full-time undergraduates and these students desire campus housing.

USM facilities are at about two-thirds capacity about two-thirds of the time. They do not operate at 100 percent capacity because of fluctuations in the needs of different courses offered at different times, among other things. This space usage pattern is similar, USM says, to patterns at higher education institutions across the country. The USM's recently announced efficiency initiative should increase its space utilization. Growth in online enrollment is a significant part of the plan and online courses reduce the need for physical classroom space (but increase the need for technology infrastructure). Many UMUC students take courses online, and UMUC accounts for about half of the projected public higher education enrollment growth through 2014.

Rather than a lack of space, the challenge with facilities seems to be functionally inadequate space. For example, some lecture rooms may have poles that block student views. These concerns help define capital projects. USM and the Department of Budget and Management are revising the space guidelines used for capital projects, and the guidelines may include more insights into the relationship between enrollment, other factors, and capital needs. The revisions are not expected to be completed in time for the fiscal 2006 budget.

Community College Enrollment Uneven, Effect on Space Also Unclear

As with USM, it is unclear how increased community college enrollment translates into building needs. Furthermore, recent community college enrollment trends are uneven. Enrollment decreased in the late 1990s, and not until fiscal 2003 did it exceed the fiscal 1996 level. Fiscal 2002 through 2004 were a time of high growth, with increases of more than 7 percent each year. However, annual increases through 2014 are projected to average 1 percent. The 2002 to 2004 fiscal crisis, during which the community college funding formulas were reduced, exacerbated community college board and administrator concern over enrollment growth. The formulas will return to full strength in fiscal 2006. The Department of Legislative Services intends to further explore community college capacity issues for the 2005 session.

This analysis includes only community college students pursuing an Associate of Arts degree. Part of the community college mission is to provide educational opportunities to non-degree seeking students. However, this analysis is concerned with community colleges' capacity to serve degree-seeking students, particularly those likely to transfer to four-year institutions to further pursue their educational goals.

Higher Education

Affordability

State funding for student financial aid increased $11.2 million in fiscal 2005, primarily for need-based aid, after two years of decreases. Since fiscal 2000, State need-based aid has increased 52 percent, while career and occupational scholarships have increased 143 percent mainly due to the HOPE scholarships. The Governor is phasing out the HOPE scholarships, with only renewals being funded beginning in fiscal 2005. Need-based aid now accounts for 61 percent of State financial aid, compared to 26 percent of University System of Maryland (USM) financial aid. Merit-based aid accounts for 58 percent of USM financial aid. In response to this imbalance in institutional aid, Chancellor Kirwan appointed a task force to make recommendations to ensure that USM institutions remain affordable and accessible. The task force has made several recommendations to increase need-based institutional aid.

Student Financial Aid Increases

After two years of decreasing appropriations, State funding in fiscal 2005 for student financial aid programs administered by the Maryland Higher Education Commission (MHEC) increased $11.2 million, or 15 percent, from fiscal 2004. Most of the increase is for need-based aid, including a 26 percent increase in the Educational Excellence Awards and a 54 percent increase in the part-time grant program. Legislative scholarships also increase by $1.3 million, due in part to tuition increases.

As shown in **Exhibit 1**, since fiscal 2000 State need-based aid has increased 52 percent, merit-based aid has remained relatively flat, and career and occupational scholarship aid to address critical workforce shortages, including the HOPE scholarships, has increased 143 percent. Funding for the HOPE scholarships is being phased out by the Governor. Only renewal awards are being funded beginning in fiscal 2005, and HOPE programs are not accepting any new applications.

Despite increased appropriations in fiscal 2005, many financial aid programs continue to have waiting lists. For the 2004 to 2005 academic year, 7,397 students are waiting for an Educational Excellence Award compared to 5,438 the previous year. The waiting lists for the other programs have either decreased or remain the same.

Exhibit 1
State Financial Aid Appropriations
($ in Thousands)

	FY 2000	FY 2004	FY 2005	2004-05 $ Increase	2000-05 $ Increase	2000-05 % Increase
Need-based Aid	$35,335	$42,386	$53,590	$11,204	$18,255	52%
Merit-based Aid	4,452	4,434	4,434	0	-18	0%
Legislative	8,261	9,610	10,861	1,251	2,600	31%
Career/Occupational	7,240	18,904	17,575	-1,329	10,335	143%
Unique Populations	385	552	640	88	255	66%
Total	**$55,672**	**$75,886**	**$87,101**	**$11,215**	**$31,429**	**56%**

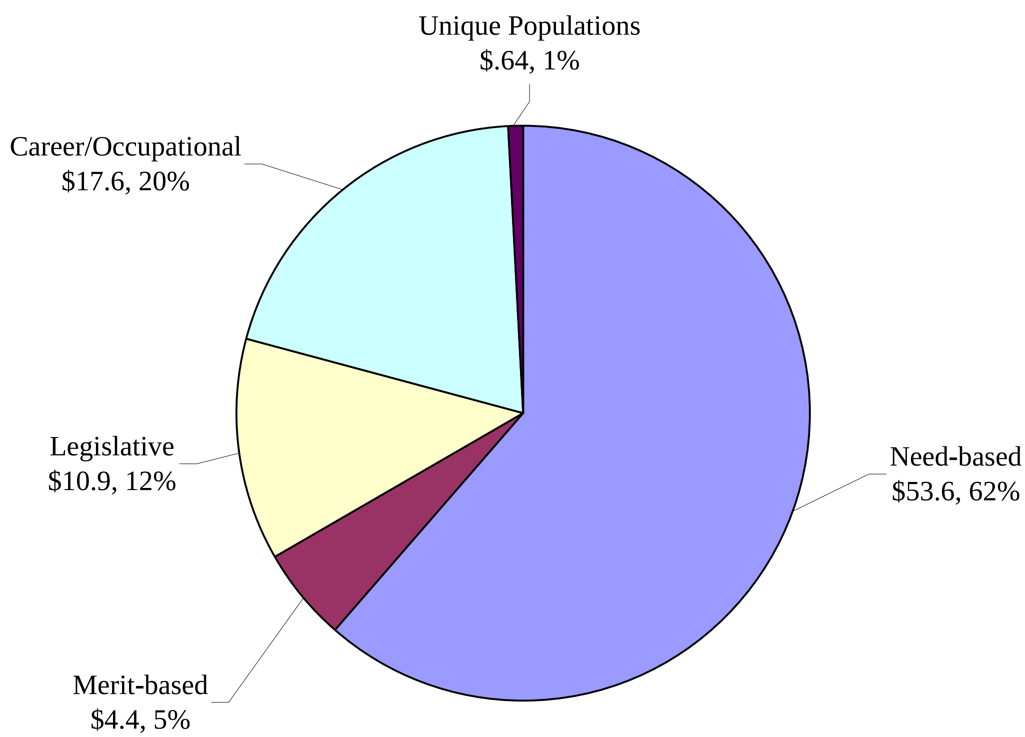
Source: Maryland Higher Education Commission, Department of Legislative Services

Need-based Aid Receives Largest Increase

A key component that impacts the affordability of Maryland's higher education institutions is the level of financial assistance awarded to students with financial need. **Exhibit 2** demonstrates how State funds were distributed among the various financial aid programs for fiscal 2005. As the exhibit shows, just over 60 percent of the funds appropriated for State financial assistance in fiscal 2005 were for need based aid, an increase of $11.2 million. Of that 61 percent, 96 percent of the funds were expended for Educational Excellence Awards. The Graduate and Professional Scholarship, the only need-based program for graduate students, received the least amount of funding at $640,000.

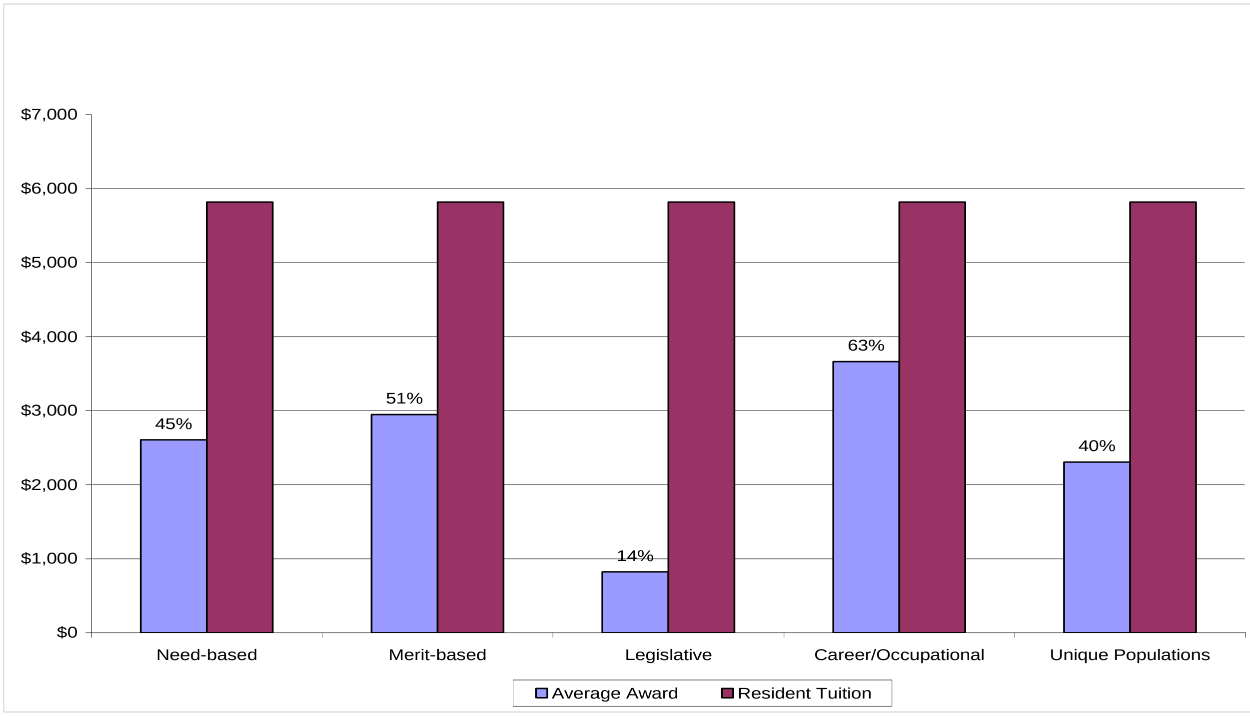
The size of the average financial aid award students receive is rising to help cover tuition increases. For example, the average Educational Assistance Grant award has increased from $1,751 in fiscal 2004 to an estimated $2,175 in fiscal 2005. **Exhibit 3** shows the average award amount of each State aid program, excluding loan assistance repayment programs, compared to the average tuition and fees of the University System of Maryland (USM) institutions, Morgan State University, and St. Mary's College in fiscal 2004 for undergraduate students. On average, the awards provided by the career/occupational aid program covered the largest share of in-state tuition at $3,664, followed by merit-based aid and need-based aid. Need-based aid covered 45 percent, on average, of in-state tuition, with career/occupational scholarships and merit-based aid meeting 63 percent and 51 percent, respectively, of tuition and fee costs.

Exhibit 2
Maryland State Financial Aid Fiscal 2005
($ in Millions)



Source: Maryland Higher Education Commission

Exhibit 3
State Aid Average Undergraduate Awards Compared to Average Tuition and Fees at USM, Morgan, and St. Mary's
Fiscal 2004

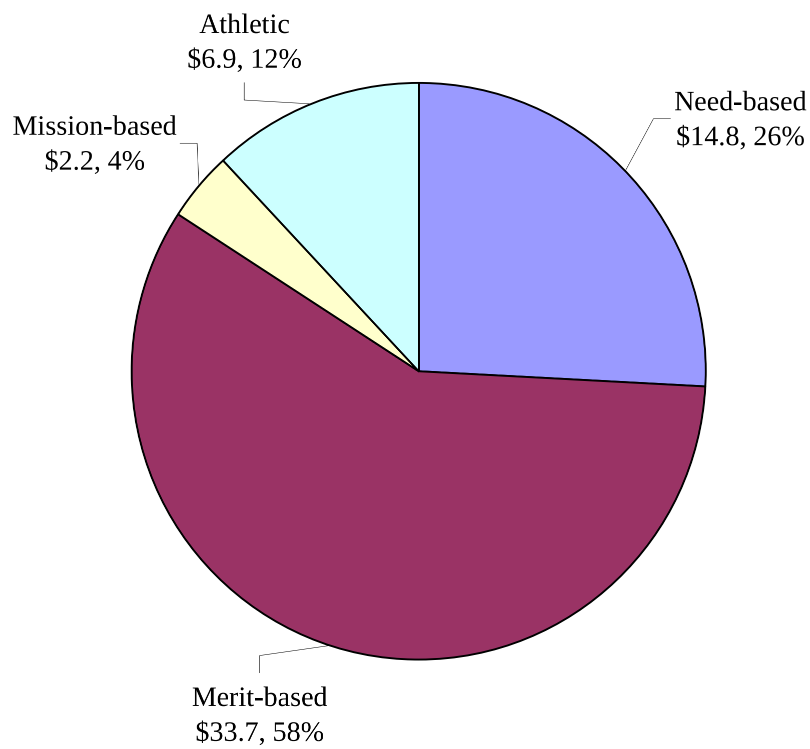


Source: Maryland Higher Education Commission, Department of Legislative Services

Institutional Aid

State financial aid programs are not the only source of aid available to students. Federal Pell grants to the financially neediest students have increased from $6 to $12 billion since 1998; however, the average award has grown only 2 percent. As a supplement to these programs, each institution provides several types of awards to its students including institutional need-based grants, merit-based scholarships, and athletic scholarships. Undergraduate institutional financial aid supports each institution's particular mission. In fiscal 2003, 22,295 USM undergraduates received $57.6 million in institutional financial aid. This represents a 23 percent increase from fiscal 2002. **Exhibit 4** shows that of the $57.6 million, 26 percent was need-based aid, which as a percentage of total institutional aid has remained relatively flat since fiscal 1999. Moreover, while need-based aid has increased 25 percent from fiscal 1999 to fiscal 2003, merit-based aid has increased 40 percent in the same period. Merit-based aid makes up 58 percent of institutional aid. Overall, institutional financial aid dollars are approximately 13 percent of total aid dollars.

Exhibit 4
Percent of Fiscal 2003 Institutional Financial Aid to USM Undergraduates by Type of Award
($ in Millions)



Source: University System of Maryland

Concerned about the imbalance between need-based and merit-based institutional aid, USM Chancellor Kirwan appointed a financial aid task force, chaired by Treasurer Nancy Kopp, to review USM financial aid programs and make recommendations to ensure that USM institutions remain affordable and accessible to qualified students. In its report to the USM Board of Regents, the task force has recommended that institutions establish a plan that would allocate a portion of funds realized from tuition increase revenues to decrease undergraduate student loan debt, particularly for the most financially needy, and provide commensurate increases in need-based financial aid to offset tuition increases. Additionally, the task force recommends that institutions reach at least the seventy-fifth percentile of institutional peers in the average percent of financial need met as a goal.

Aid to Community College Transfers

MHEC administers 24 different scholarship programs, the majority of which are targeted toward students at four-year institutions, particularly freshmen. The Community College Transfer (CCT) scholarship, a component of the HOPE program, is for students who transfer from a Maryland community college to a Maryland four-year institution for full-time enrollment. In its proposed State plan, MHEC recommends that the State consider incentives to enable more prospective students to attend community colleges as a cost-effective measure for both the State and the students. The CCT program received approximately $224,000 in fiscal 2004 and issued 82 awards. But as part of the phase-out of HOPE scholarships, no new awards are being made, and MHEC estimates four recipients will receive renewal awards in fiscal 2005.

Higher Education

Veto of the Higher Education Affordability and Access Act of 2004 (House Bill 1188)

In the 2004 session, the General Assembly passed House Bill 1188, which would have limited tuition increases and enhanced funding at State universities and colleges for three years. The Governor vetoed this legislation on policy grounds, and the Attorney General was asked how House Bill 1188 would be implemented if the veto was overridden during the 2005 session. The Attorney General has concluded that the corporate tax surcharge would remain in effect for three years, but the 5 percent tuition cap and additional funding for higher education would only be in effect for two years. Separate legislation would be needed to provide a third year of funding and tuition caps.

Access and Affordability

In October 2003, the House Special Committee on Higher Education Affordability and Access was established to address concerns over the affordability of higher education in the wake of dramatic tuition increases and reductions in State support for public universities and colleges. The committee held meetings on college campuses across the State to examine the operations and funding needs of the State's higher education institutions and the impact of tuition increases on students and their families. It developed strategies to maintain affordability and access while preserving the quality of education and national preeminence of the State's universities.

House Bill 1188

During the 2004 session, House Bill 1188 was introduced to implement the recommendations of the special committee. As passed, the bill would provide additional State support for the University System of Maryland (USM) and Morgan State University in exchange for limiting tuition increases to 5 percent annually for three years. The legislation would make a supplementary appropriation in fiscal 2005 of $25.4 million to USM and $1.6 million to Morgan State. Additionally, the bill would require for fiscal 2006 and 2007 that the Governor include an appropriation in the annual State budget of at least 5 percent over the previous fiscal year.

To pay for the increased State support provided under the bill, the corporate income tax rate would increase by 10 percent – from 7 to 7.7 percent – for tax years 2004 through 2006 and the additional revenues would be deposited in a Higher Education Investment Fund (HEIF). The Governor may include up to 60 percent of the annual State increase from the fund. Any balance remaining in the HEIF would be transferred to the general fund at the end of fiscal 2007 to be used to support higher education. Additionally, House Bill 1188 would create a commission to study the coordination, funding, educational delivery, and State commitment to higher education in the State.

Governor's Veto of House Bill 1188

In his veto letter, Governor Robert L. Ehrlich, Jr. gave several policy reasons for vetoing House Bill 1188. The Governor stated that the legislation would create an unfunded mandate because new revenues would only cover 60 percent of the additional funding required under the bill. He raised concerns that the funding gap would result in general fund reductions to other State agencies. The Governor also opposed increasing the corporate income tax because of the impact it may have on Maryland businesses.

Fiscal Impact of a Veto Override of House Bill 1188

In a letter dated August 26, 2004, the Attorney General's Office outlined how it believes House Bill 1188 would be implemented in the event of a veto override during the 2005 session. According to the letter, the 10 percent surcharge should be given effect in tax years 2004, 2005, and 2006. However, since half of the academic and fiscal year would be over at the time of a veto override, the 5 percent tuition cap would only apply to academic years 2005 to 2006 and 2006 to 2007, predicated upon a 3.4 percent supplemental appropriation for fiscal 2006 and a mandated 5 percent increase in State funding for fiscal 2007. The Attorney General believes that it is the legislature's intent that the 10 percent surcharge on the corporate income tax should apply to tax year 2004, even though there would be no supplemental appropriation in fiscal 2005 to higher education institutions and no corresponding tuition limitation in the 2004–05 academic year. Thus, the corporate tax surcharge would be in effect for three years, but the additional funding for higher education and 5 percent cap on tuition would only be in effect for two years.

According to the Attorney General's analysis, there would be no difference in the implementation of House Bill 1188 should the General Assembly override the Governor's veto in a special session in 2004 or in the 2005 session. In both cases, the imposition of the 10 percent corporate income tax surcharge would apply to tax year 2004. It is foreseeable that this interpretation could be challenged in court, especially if the override occurs in January 2005, after the tax year has ended and the Comptroller's income tax instructions have already been mailed out. An argument can be made that the legislature intended the corporate surcharge to be of the same duration as the mandated funding increase for higher education (*i.e.*, now just two years according to the Attorney General's Office).

Another consideration should the House Bill 1188 veto be overridden is that the funding and tuition provisions would only apply to two fiscal years (fiscal 2006 and 2007). Not only will this leave a surplus in the HEIF, but it fails to meet the legislature's goal of stabilizing higher education funding and tuition increases for three years. To achieve this objective, additional implementing legislation will be required.

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Higher Education

State Plan for Postsecondary Education

In April 2004, the Maryland Higher Education Commission established a special committee of educators and government officials to update the Maryland State Plan for Postsecondary Education. The committee released a draft of its report in October 2004. The final report will be submitted in January 2005.

State Planning Committee for Postsecondary Education

Section 11-105 of the Education Article requires the Maryland Higher Education Commission (MHEC) to develop and periodically update a State Plan for Postsecondary Education (State Plan). The plan must identify the present and future needs and capabilities of higher education institutions and develop long-range and short-range goals for postsecondary education. In April 2004, MHEC established a 38-member planning committee, chaired by the Secretary of Higher Education, to update the State Plan. The committee and its subcommittees met throughout the summer and fall months and issued a draft report in October 2004. After approval by MHEC, the State Plan must be submitted to the Governor and the General Assembly by January 1, 2005.

2004 Goals for Postsecondary Education

The State Planning Committee focused its study and recommendations in five areas of higher education: quality and effectiveness, access and affordability, student-centered learning systems, economic growth and vitality, and diversity. The committee adopted the following goals and recommended actions in each of these areas.

Quality and Effectiveness

Goal: ***Maintain and strengthen a preeminent statewide system of postsecondary education recognized nationally for its academic excellence and effectiveness.*** The committee recognized that this goal is threatened by the substantial increase in enrollments expected over the next decade and the sharp reduction in State aid to institutions of higher education. MHEC projects that enrollment at State colleges and universities will increase by greater than 57,000 students, or 23 percent, by 2013. The committee noted that State general fund support for higher education decreased 11 percent between fiscal 2002 and 2004.

The committee made the following recommendations to strengthen the quality of higher education:

- The State should fund higher education based on the funding guidelines established in statute for four-year public institutions.

- The State should fully fund community colleges and independent institutions based on existing statutory formulas.

- The State should continue to provide matching funds to encourage private donations to colleges and universities.

- The State should aggressively invest in faculty development and advanced technologies in instruction.

Access and Affordability

Goal: ***Achieve a system of postsecondary education that promotes accessibility and affordability for all Marylanders.*** The committee recognized that most institutions do not have the current capacity to accommodate the expected enrollment growth over the next decade. It further noted that Maryland received a grade of "F" in affordability in the *2004 State-by-State Report Card for Higher Education.*

The committee made the following recommendations to ensure public universities and colleges are accessible and affordable:

- The State should study and revise the capital improvement planning process as it relates to higher education facilities.

- MHEC should develop a 10-year growth plan for higher education institutions that provides access to students in a cost effective manner.

- MHEC should develop a policy on regional higher education centers.

- MHEC should propose a model to expand digital and online education.

- The State should revise its need-based aid programs to allow more students to receive aid and increase awards to promote access.

Student-centered Learning Systems

Goal: ***Strengthen and expand teacher preparation programs and support a student-centered education system.*** The committee recognized that Maryland faces a critical shortage of teachers, and State universities and colleges are graduating less than half of the new teachers needed in Maryland schools. This comes at a time when the State is phasing out the HOPE Teacher Scholarship program, although the Christa McAuliffe Teacher Scholarship will remain.

The committee made the following recommendations:

- Maryland colleges and universities should increase capacity in teaching programs to help meet the teaching needs of local school systems.

- MHEC should promote efforts to reduce average time-to-degree at public institutions of higher education.

- MHEC should promote greater collaboration between colleges and universities and pre-K-12 schools.

- MHEC should work with institutions to ensure that space will be available for community college students transferring to four-year institutions.

Economic Growth and Vitality

Goal: ***Promote economic growth and vitality through the advancement of research and the development of a highly qualified workforce.*** The committee recognized that the research conducted at Maryland universities and the commercialization of intellectual property play a vital role in keeping Maryland's economy vibrant and competitive. The committee also noted that institutions of higher education must increase the supply of qualified graduates in critical workforce shortage areas.

The committee made the following recommendations to promote economic growth and vitality:

- The State should promote public policies that encourage academic research and development efforts at public universities and colleges.

- The State should provide improved economic data necessary for educational institutions to respond to workforce shortage needs.

- Institutions of higher education should increase the supply of qualified graduates in high demand fields and workforce shortage areas.

- The State should establish an Education Committee of the Governor's Workforce Investment Board.

Diversity

Goal: ***Ensure equal educational opportunity for Maryland's diverse citizenry.*** The committee recognized that universities and colleges must continue to ensure equal access to higher education for all residents and promote the participation of racial and ethnic minorities.

The committee noted that the partnership agreement with the U.S. Department of Education's Office for Civil Rights requires the State to make significant ongoing investments in higher education.

The committee made the following recommendations to promote diversity and minority achievement at Maryland's institutions of higher education:

- MHEC should develop a statewide workshop pertaining to "cultural competence" and institutions should offer programs that encourage cultural awareness.

- MHEC should identify the enhancement funds needed to realize parity at the State's historically black colleges and universities.

- Institutions should form a statewide advisory group to promote academic advising practices to ensure academic success and narrow the graduation gap for minority students.

- Institutions with advanced degree programs should aggressively recruit racially and ethnically under-represented students into these programs.

The State Planning Committee is expected to approve the final draft of the State Plan by the end of November 2004. The plan will then be submitted to the Maryland Higher Education Commission for its approval.

Higher Education

Ambitious Efficiency Initiatives Unveiled by University System of Maryland

In June 2003, the University System of Maryland began a major study to improve the efficiency and effectiveness of its institutions to reduce costs and accommodate future enrollment growth. The efficiency study was completed in October 2004 and includes initiatives representing an estimated $26.6 million in financial benefits, including cash savings, beginning in fiscal 2006.

Given the continuing constrained State fiscal environment, the University System of Maryland (USM) Board of Regents has examined how the system can improve its efficiency. After more than a year of study, USM unveiled its efficiency and effectiveness plan in October 2004. The system will pursue more than a dozen initiatives that it expects will result in financial benefits of $26.6 million in fiscal 2006. Some of the new initiatives will continue through 2008.

As indicated in **Exhibit 1**, the $26.6 million incorporates several types of positive financial effects, including cash savings, cost avoidance, attainment of new revenues, and reallocation of resources. At this point, USM has not determined amounts associated with each type of effect. An example of cash savings would be cutting adjunct faculty positions, while cost avoidance would be not hiring additional faculty to teach a new course. USM has indicated that $2 million of a $45 million supplemental general fund request would be applied toward the efficiency initiatives.

The efficiency plan is ambitious. It has implications for the way students plan their coursework and the way faculty manage their workload. It calls for centralizing administrative activities among 13 institutions with extensive control over their own budgets. In the spirit of accountability, the plan anticipates that financial gains may be measured against Managing for Results and other indicators to see the relationship between dollars saved to quality improved.

Exhibit 1
University System of Maryland Efficiency Initiatives
($ in Millions)

Academic Initiatives	**Estimated Fiscal 2006 Effect**	**Cost Savings**	**Cost Avoidance**
Enrollment management to redirect new enrollments	$5.1	X	X
Increase in faculty instructional workload, streamlining of enrollment services, other academic and student support	4.4	X	X
Academic Initiatives Subtotal	**$9.5**		
Administrative Initiatives			
Centralization or integration of human resources, accounting and other functions	$2.1	X	X
Cooperative procurement	3.1		X
Energy management	2.2	X	
Ongoing improvements at individual institutions	9.7	X	X
Administrative Initiatives Subtotal	**$17.1**		
Effect of Initiatives	**$26.6**		
Supplemental general funds requested to support initiatives	(2.0)		
Net Total Effect	**$24.6**		

Note: Administrative initiatives will include technology commercialization and a potential structural reorganization. These financial effects are as yet undetermined.

Source: University System of Maryland

Academic Initiatives

Five of the efficiency initiatives focus on academic programs. The initiatives center on accommodating higher enrollment through higher faculty workloads, expanding online learning, and moving undergraduate students through their courses of study more quickly. USM has established the goal of accommodating an additional 2,100 students at its institutions over the next three years at no cost to the State. The academic initiatives involve:

- **Faculty course loads:** The Department of Legislative Services presented information during the 2004 session that indicates that USM institutions are, on average, at the low end of the Board of Regents standard for faculty instructional workload. USM proposes to bring faculty workload to the mid-point of this standard, which will generally result in a 10 percent increase in faculty course load. The additional course offerings will be dependent on adequate space and support resources.

- **Online learning:** System-wide committees will be established to identify, develop, and implement online learning opportunities within and among institutions. Greater online course offerings will improve student access and facilitate timely degree completion.

- **Capacity/time to degree:** USM institutions will develop initiatives to accommodate expanded enrollment and promote faster degree completion. Examples include developing room utilization plans to maximize the use of facilities, limiting most degree requirements to 120 credits, and imposing financial penalties on students who take an excessive number of credits. Another proposal would require many students to complete 12 course credits outside the classroom through experiences such as online education, independent study, and internships.

- **Manage enrollment:** The Board of Regents will devise an enrollment policy that will use tuition differentials to channel more undergraduate enrollments to institutions with excess capacity and to lower-cost institutions. This initiative depends heavily on student preferences and the availability of programs at targeted institutions.

- **Enrollment services:** Institutions will use best practice models to streamline enrollment services, including consolidating undergraduate and graduate admissions processes, promoting online admission procedures, and automating grading and billing practices.

Administrative Initiatives

The administrative initiatives focus on increasing collaboration among institutions and boosting use of technology. They are expected to account for most ($17.1 million) of the fiscal 2006 gains from the new efficiency effort, as shown in Exhibit 1. A study by the consulting firm Accenture informed development of these initiatives, along with institutions' administrative officers. Accenture generally recommended that the system centralize and integrate a number of functions to take advantage of its size. The administrative initiatives include:

- **Information technology and administrative systems:** Information technology is the linchpin for consolidating other functions such as human resources and accounting.

- **Procurement:** Although USM institutions already cooperatively purchase some commodities, they will identify additional opportunities and set up formal procedures.

- **Energy purchasing and demand management:** Energy, particularly natural gas, is identified as an important case where USM institutions can purchase cooperatively and reduce costs. USM institutions also will study energy use and efficiency.

- **Real property:** Development options may be considered for up to 40 properties that do not contribute to USM institutions' master plans.

- **Administrative economies of scale:** USM will study whether a shared services center could decrease transaction costs related to accounts payable and travel, among others. In-house processing of payroll and accounts payable also will be studied.

- **Technology commercialization:** USM intends to generate new revenues and commercial ventures with additional research funds and intellectual property.

- **Organizational structure:** USM as a whole and four institutions will be studied to see if their performance could benefit from a new structure. The institutions are the University of Baltimore, the University of Maryland Biotechnology Institute, the University of Maryland Center for Environmental Science, and the University of Maryland University College.

All the new efficiency initiatives focus on system-wide functions. Additional financial benefits are expected from ongoing efficiency improvements at individual campuses, on which USM reports annually. Although there will be some overlap, the system intends to attribute only part of the financial gains from ongoing improvements to the new initiatives.

Other Possible Opportunities to Save

The USM efficiency plan covers a wide range of activities. However, a few others offer possible ways to save costs. To shorten the time to degree, Virginia and Iowa are among the states that enable high school students to take college courses (these efforts also can alleviate crowding at K-12 facilities). Also, increasing community college transfers can increase overall higher education capacity. Finally, it is unclear to what extent sharing of resources and facilities, such as libraries, is emphasized in the USM plan.

Higher Education

Selected Executive Salaries at University System of Maryland Tend to Be Above Median, Mid-level Administrative Salaries Are Closer to Median

Salaries for selected executive administrative positions at the University System of Maryland (USM) tend to be above the national median, according to a salary study conducted by the Department of Legislative Services (DLS). Salaries for mid-level administrative positions are closer to the regional median, with several institutions above the median for certain positions. The USM Board of Regents policy that administrative salaries should be above the median is based on public institutions; however, the only readily available national data includes public and private institutions. DLS has requested additional data to determine how USM administrative salaries compare to median salaries for public institutions.

Salaries for five selected executive positions at University System of Maryland (USM) institutions tend to be above the national median. For three selected mid-level administrative positions, salaries at USM institutions are clustered more closely to the regional median. These results are based on a salary survey for which about half the respondents are public institutions and about half are private institutions.

The USM Board of Regents has a policy that administrative salaries should be above the median for peer institutions. However, the policy assumes a comparison only to public institutions. No data are readily available that show whether public or private institutions' overall salaries tend to be higher. In the case of university presidents, public salaries historically have been lower, unless compensation is supported by funds from private sources.

This analysis of administrative salaries by the Department of Legislative Services follows the faculty salary analysis conducted for the 2004 legislative session. That study found that average faculty salaries at Maryland's four-year public higher education institutions vary widely compared to peers in other states. Some ranked as high as 100 percent and others ranked as low as 40 percent.

The administrative salary analysis is based on fiscal 2004 data from the College and University Professional Association (CUPA) for Human Resources. Salaries for positions at or above the director level are reported with executive-level data, while positions below the director level are reported in mid-level data.

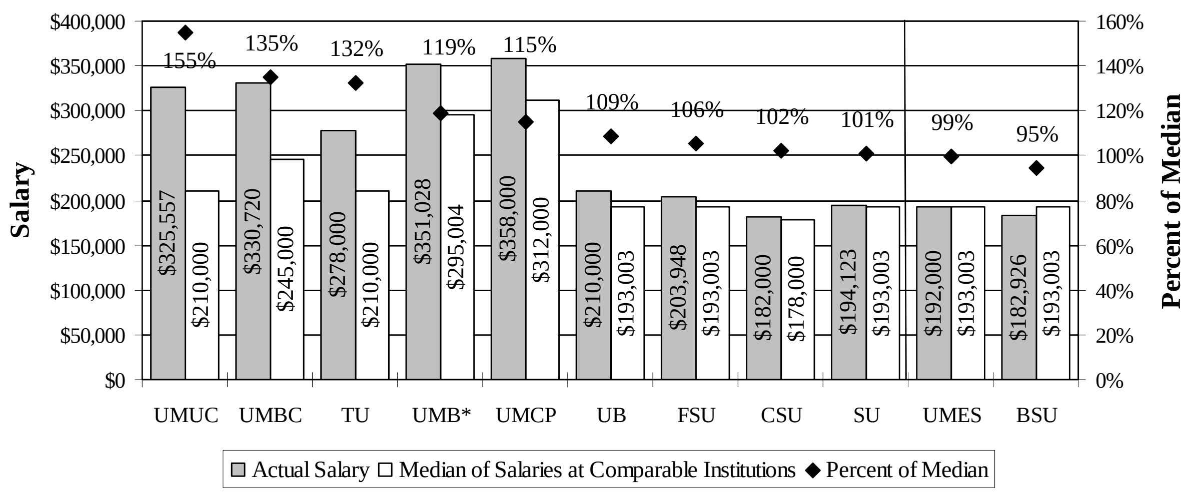
Executive-level Salaries

Five executive positions (president, director of library services, chief business officer, chief of personnel, and registrar) were selected for the comparison to represent several functional administrative areas. USM research institutions and Towson University (TU) tended to be the furthest above the medians in the five positions studied.

For executive-level positions, CUPA categorizes institutions according to their operating budget size and compares them on a national level since institutions draw from a nationwide pool to fill top-level vacancies. The fiscal 2004 data represents 1,379 institutions, of which 52 percent are public and 48 percent are private.

A comparison of the fiscal 2004 salaries of USM presidents and median salaries of presidents at similar-size institutions is shown in **Exhibit 1**. The chart reveals a wide range of salaries for USM presidents, from $182,000 for the President of Coppin State University (CSU) to $358,000 for the President of the University of Maryland, College Park (UMCP). As shown by the median salaries at comparable institutions, which range from $178,000 to $312,000, this disparity is not unexpected given the different sizes of USM institutions.

Exhibit 1
Salaries of Presidents at University System of Maryland Institutions
Fiscal 2004



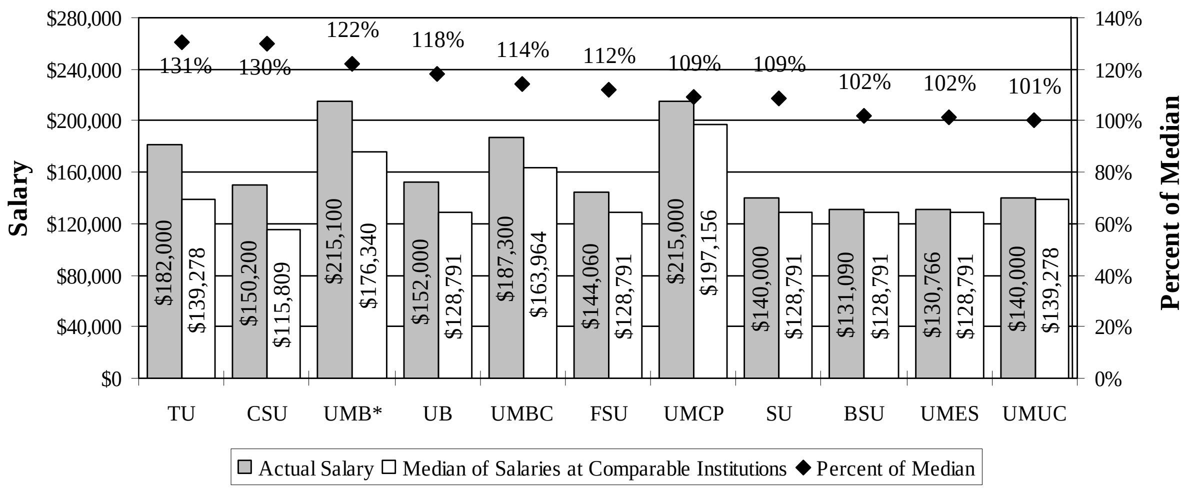
* UMB compares the salary of its president to the median salary for presidents at academic health centers, $354,700, not the CUPA median.

Source: College and University Professional Association for Human Resources and Department of Legislative Services

The graph also shows the percent of the comparable median salary that each USM president's salary comprises. Values on the left side of the vertical line indicate salaries above the national median, and values on the right of the vertical line indicate salaries below the median. All but two USM institutions pay their presidents more than the medians. Furthermore, three USM institutions – the University of Maryland University College (UMUC), the University of Maryland Baltimore County (UMBC), and TU – pay their presidents more than 30 percent above the national medians. In contrast, the six USM presidents with the lowest salaries are all paid within 10 percent of the comparable national medians.

The fiscal 2004 salaries of chief business officers at USM institutions are shown in the same format in **Exhibit 2**. The salaries do not vary as much as presidents' salaries, ranging from a low of $130,766 at the University of Maryland, Eastern Shore (UMES) to a high of $215,100 at University of Maryland, Baltimore (UMB). All the salaries, however, exceed the national medians for chief business officers in comparably sized institutions. Six USM institutions pay their chief business officers salaries that are more than 10 percent above the comparable national medians.

Exhibit 2
Salaries of Chief Business Officers at University System of Maryland Institutions
Fiscal 2004



* UMB compares the salary of its chief business officer to the median salary for these positions at academic health centers, $205,000, not the CUPA median.

Source: College and University Professional Association for Human Resources and Department of Legislative Services

Although salaries of other selected executive-level positions were not above CUPA medians as consistently as presidents and chief business officers, they are competitive when compared to national peers. USM salaries for chiefs of personnel ranged from 91 to 131 percent of the medians, with 8 of the 11 degree-granting institutions paying above the medians. Salaries for registrar ranged from 65 to 150 percent of the medians, with six USM institutions paying above the medians. Salaries for director of library services ranged from 82 to 125 percent of the medians, with five institutions paying above the medians.

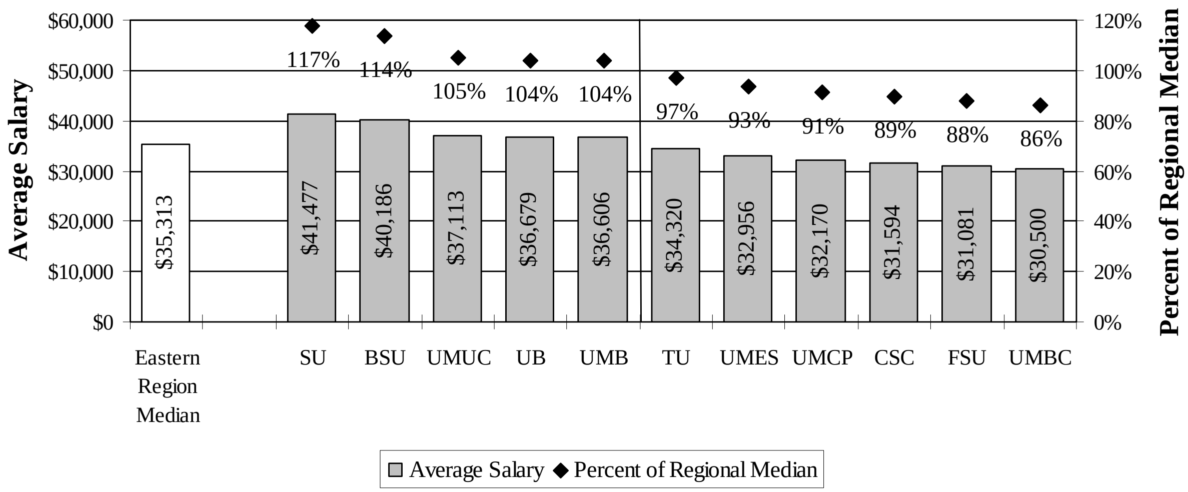
Mid-level Salaries

For mid-level administrative positions, four USM institutions use one salary structure and the other nine USM institutions use another structure. Three mid-level administrative positions – financial aid counselor, accountant, and academic advisor – were selected for the comparison. Like the executive positions, they represent several functional areas. CUPA data for mid-level comparisons are condensed into a regional median since recruitment for these positions is usually regional.

The regional medians reported by CUPA for each position apply to all institutions in the region regardless of their budget sizes. The mid-level salary survey had 1,131 institutions responding, and public and private institutions each accounted for approximately 50 percent of the sample. For purposes of the survey, the eastern region includes Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont.

Average salaries at USM institutions for one mid-level administrative position, financial aid counselor, are shown in **Exhibit 3**. According to CUPA, the median fiscal 2004 salary for financial aid counselors working in the eastern region was $35,313. The average salaries at USM institutions ranged from $30,500 at UMBC, 86 percent of the regional median, to approximately $41,500 at Salisbury University (SU), 117 percent of the regional median. Five USM institutions reported average salaries for financial aid counselors that exceeded the regional median, and six reported average salaries below the median.

Exhibit 3
Average Financial Aid Counselor Salaries at University System of Maryland Institutions
Fiscal 2004



Source: College and University Professional Association for Human Resources and Department of Legislative Services

Salaries for accountants and academic advisors at USM institutions are fairly close to the regional median when considered as a systemwide average. As with the financial aid counselor position, however, salaries for these positions vary among the institutions.

Higher Education

More Equitable Treatment of Regional Higher Education Centers Proposed

The seven regional higher education centers in the State operate under a variety of governance structures and receive varying amounts of State support. The result is a mixture of success among the centers in terms of student enrollment and institutional participation. The Maryland Higher Education Commission recently submitted a response to the *2004 Joint Chairmen's Report* that makes numerous recommendations to provide more equitable treatment of regional centers across the State and encourage greater participation from institutions and students.

Seven Regional Higher Education Centers in Maryland

There are seven regional higher education centers located throughout Maryland. The University System of Maryland (USM) operates two centers, and there are four independent centers that exist in areas not served by comprehensive four-year institutions. A regional higher education center includes participation by two or more institutions of higher education, consists of a variety of program offerings, and offers multiple degree levels. These centers provide a full range of postsecondary programs and services including lower- and upper-level undergraduate degree programs as well as graduate and professional degree programs. The purpose of regional higher education centers is to provide access to higher education programs in unserved or underserved areas of the State and to respond to the needs of businesses and industries in the areas in which they serve.

Since 2000, the Maryland Higher Education Commission (MHEC) has been responsible for the coordination of the regional higher education centers. This responsibility includes approving the centers' mission statements and ensuring that the programs and courses offered are within the scope of the approved mission statements. In addition, MHEC makes recommendations for State funding for the centers to the Governor. The *2004 Joint Chairmen's Report* required MHEC to submit a report examining Maryland's regional higher education centers, specifically the centers' role in delivery of higher education, their potential to provide greater access to higher education in underserved areas of the State, the barriers to academic program delivery, and equitable funding mechanisms. MHEC submitted its report to the budget committees in October 2004 and made several recommendations, including the need for (1) a comprehensive State policy for regional higher education centers, (2) development of a funding policy, (3) additional need-based financial aid (4) enhancement of the delivery of academic programs, (5) providing information on needed programs to encourage institutional participation and, (6) improved data on workforce needs.

Policy Issues Raised

The regional higher education centers all have different missions, governance structures, institutional partners, and academic programs. As a result, each center faces its own unique issues and challenges.

Funding

The operating budget requests and proposals for capital projects for all centers, including those that are USM-administered, are included in the consolidated operating and capital budget request for higher education, which MHEC submits to the Governor. All operating funds for centers that are not USM-administered are provided as grants through MHEC's operating budget. USM administers operating funding for the Shady Grove and Hagerstown centers.

Exhibit 1 shows that in the last 10 years the State has provided a total of $46.3 million in capital funding for new facilities at the Southern Maryland, HEAT, Shady Grove, Eastern Shore, and Hagerstown centers. The Waldorf and Laurel centers lease facilities and have not received capital funding**.** Exhibit 1 also shows that three of the seven centers, Shady Grove, Hagerstown, and Southern Maryland, have received State general operating funds. The centers that do not receive State operating funds have requested State funds for several years (the Laurel center was approved in 2004 and requested funds for the first time for fiscal 2006). The Waldorf center, the only center that has not received any State operating or capital funding, has requested $24.5 million in capital funds for a new building.

The HEAT and Southern Maryland centers receive operating funds from the counties they serve. However, most counties are reluctant to provide funding to the centers because the county already supports the local community college. The ultimate goal for the centers is that they become self-sufficient. However, this may not be possible without some form of consistent and equitable State funding. The non-USM centers charge fees to participating institutions that partially cover their costs. The MHEC report suggests either the use of start-up funds for only new centers or incentive based funding to support high-demand, high-cost programs that are needed at a particular center as the programs are critical to the workforce in that region.

Exhibit 1
Regional Higher Education Centers in Maryland

Center (year established)	FTE's (Actual FY 2004)	FTE's (Est. FY 2005)	Degree Programs	Number of Participating Institutions	Total State Operating Funds FY 1995-2005	Total State Capital Funds FY 1995- 2005
USM – Shady Grove (1996)	1,125.9	1,185.2	20 Bachelor's 13 Master's	8	$16,627,668	$15,356,604
USM – Hagerstown (2005)	N/A	140.4	Planned for 2005: 6 Bachelor's 6 Master's	3	$1,000,000	$16,361,000
Eastern Shore Higher Education Center (2002)	21.0	28.0	1 Bachelor's 2 Master's	3	$0	$7,770,000
HEAT Center (1995)	93.3	96.4	2 Associate's 4 Bachelor's 9 Master's	7	$0	$1,000,000
Southern Maryland Higher Education Center (1995)	388.0	482.0	5 Bachelor's 35 Master's 1 Doctorate	8	$1,262,000	$6,845,000
Waldorf Higher Education Center (1997)	309.5	341.5	6 Associate's 9 Bachelor's 2 Master's	4	$0	$0
Laurel Center* (2004)	283.0	334.6	Planned for 2004: 2 Associate's 2 Bachelor's	3	$0	$0

*Laurel Center has offered community college courses since 2001. The first year of upper-level undergraduate courses will be offered in 2004.

Source: Maryland Higher Education Commission and the regional higher education centers

Governance

Each of the seven regional higher education centers has its own system of governance. The Shady Grove and Hagerstown centers are both governed by USM. Shady Grove also has a board of advisors, and the Hagerstown center is working to establish the Hagerstown Governance Council. The Board of Governors for the Southern Maryland center and their powers and duties were created by statute. For the Eastern Shore center, there is a Memorandum of Understanding which states that the Eastern Shore Association of College Presidents

(Salisbury University, University of Maryland Eastern Shore, Washington College, and Chesapeake College) serves as the governing body, and Chesapeake College serves as facilities manager. Similarly, a Memorandum of Agreement between the College of Southern Maryland and the University of Maryland University College governs the Waldorf center. At the HEAT center, the chief executive officer or designee from the Harford County government, Maryland Transportation Authority, and Harford County Community College (HCCC) make up the Managing Partners Group, while HCCC is responsible for the day-to-day operations of the center. The new Laurel center is jointly managed by the Prince George's Community College and Howard County Community College.

The governance structure of a regional higher education center directly impacts institutional participation and the academic offerings at each center. Some centers permit participation from all types of institutions whether they are in-state, out-of-state, or for-profit or not-for-profit. Other centers are limited by their governance structure to work only with certain types or specific institutions. This presents a problem when a center has the demand for programs and willing institutions to participate but because of the center's governance structure, the center is not able to work with the particular institution. A possible solution suggested in the MHEC report proposes to have MHEC develop a procedure similar to the request for proposal process in which MHEC would notify all higher education institutions in the State when a new program is needed at a center. This more coordinated process may help institutions respond to the identified needs at the centers. Taking this idea a step further, centers and institutions that receive State support (operating or capital) could be required to participate in the MHEC process as a condition of receiving State funding.

Productivity

The MHEC report stressed the need for regional higher education centers due to the increasing demand for baccalaureate and graduate degrees coupled with the decreasing capacity at the State's public institutions of higher education. In order for centers to be productive, they must focus on institutional participation and student enrollment. Exhibit 1 shows that as more institutions partner with centers, their academic offerings increase, as does student enrollment. An important relationship for the centers continues to be with their local community colleges. The centers should continue to work with the community colleges to develop concurrent or dual enrollment programs and to articulate two-year and four-year programs in order for students to easily transition from community colleges to institutions participating at centers.

Health and Health Insurance

Prescription Drugs

During the 2005 session, deliberations are likely on a number of key prescription drug issues, including how to contain the rising cost of prescription drugs, maintaining or expanding access for people who have no public or private coverage, and the future of existing programs that help low-income individuals pay for prescription drugs with the implementation of the new Medicare prescription drug benefit on January 1, 2006.

Rising Cost of Prescription Drugs

Maryland public programs have experienced double-digit growth in prescription drug costs in the past five years, averaging 16.2 percent per year in the State Employee Health Benefit Program and 17.2 percent per year in the Maryland Medical Assistance Program. These figures are consistent with data from the National Health Account, as reported in the January/February 2004 issue of *Health Affairs*, indicating that U. S. spending for retail prescription drugs grew by 15.6 percent from 2001 to 2002, reaching 10.5 percent of overall health spending and 1.56 percent of the gross domestic product. The long-term growth trend was attributed to more generous insurance coverage of drugs and the introduction of newer and more costly drugs.

Strategies to Contain Rising Drug Costs

Third-party payers, which saw their share of the nation's drug bill rise from 32 percent in 1980 to 70 percent in 2002, have turned to pharmacy benefits managers (PBM), multi-tier cost sharing, and the use of generics to slow rising drug costs and make consumers more cost conscious. Maryland has done the same, contracting with a PBM to run the State Employee Health Benefit Program and requiring employees to pay higher co-payments for nonpreferred drugs. Unlike many private employers, however, Maryland has not made mail order drugs available to State employees. State law prohibits insurance carriers from offering a financial incentive for the use of mail order.

Maryland has implemented and continues to pursue both budgetary and statutory solutions to the escalating cost of prescription drugs. On the budgetary side, the Department of Budget and Management (DBM) is proposing to raise the co-payments required of State employees and retirees and is weighing other options as well. (See issue paper on Employee Health Insurance under the Personnel heading for a more complete discussion.) In the Maryland Medical Assistance Program, during the 2004 session, legislative budget language reduced pharmacy dispensing fees, imposed co-payments ranging from $1 to $2 on Medicaid beneficiaries for whom the federal government allows cost sharing, and required the Department of Health and Mental Hygiene (DHMH) to develop a pharmacy care management program for nursing home residents. Legislative budget language also directed DBM and DHMH to jointly explore the possibility of developing a single preferred drug list for the State Employee Prescription Drug Program and Medical Assistance.

According to the National Conference of State Legislatures Health Policy Tracking Service, states have looked at drug rebates and discounts, preferred drug lists, bulk purchasing agreements, PBM regulation, drug importation, and price controls to restrain rising drug costs. Maryland has adopted rebates and preferred drug lists but has not moved forward with these other strategies.

Rebates, Discounts, and Preferred Drug Lists

Federal law requires drug manufacturers to enter into national rebate agreements to receive federal funding for drugs dispensed to Medicaid enrollees. States have also been permitted to negotiate supplemental rebates beyond those required by federal law. A drug manufacturer or wholesaler will offer the state a supplemental rebate for placement of their drugs on a preferred drug list. Thirty-four states, including Maryland, have established preferred drug lists in their state Medicaid programs. Medicaid enrollees are required to use the preferred drug, unless the prescriber documents the need for the enrollee to receive another drug in that class. DHMH reports successful implementation of the preferred drug list, with very few requests for nonpreferred drugs, and predicts that savings, originally estimated at $16 million, could be at least $30 million per year.

As mentioned above, fiscal 2005 budget language required DBM and DHMH to examine the possibility of a joint preferred drug list as a cost-saving measure. The departments currently use separate preferred drug lists. In October 2004, the departments reported that a single preferred drug list was unworkable due to federal restrictions and would not provide substantial savings.

Bulk Purchasing Agreements

Bulk purchasing agreements give states additional bargaining power with drug manufacturers by increasing the volume of customers. In April 2004, the federal Centers for Medicare and Medicaid (CMS) approved a multi-state drug purchasing program for Medicaid. The five participating states will initially purchase drugs using the same pharmacy benefit manager but will be allowed to maintain their own preferred drug list if they wish. The five states anticipate saving at least $12 million through the bulk purchasing agreement.

DHMH has had discussions with the participants in the multi-state agreement and is considering applying to CMS to join the agreement. With about 100,000 Medicaid enrollees shifting to Medicare prescription drug benefits in 2006, the Medical Assistance Program could lose its bargaining power with drug manufacturers for supplemental rebates. Multi-state pooling may afford the State the continued opportunity to receive favorable rebates.

PBM Regulation

Citing the need for greater transparency in the relationships among PBMs, pharmaceutical manufacturers and prescription drug purchasers are also concerned that PBMs are retaining rebates that should be going to the purchasing entity; 14 states and the District of Columbia introduced legislation in 2004 to regulate PBMs. Only South Dakota and the District of Columbia enacted legislation requiring PBMs to disclose information about rebates, discounts, and other financial information.

In Maryland, House Bills 397 and 840 of 2004, as originally introduced, would have increased State regulation of PBMs by establishing a fiduciary relationship between a PBM and the entity purchasing its services and requiring PBM to disclose to the purchaser all financial and utilization information requested by the entity regarding its enrollees. House Bill 397 would have also required PBMs to register with the State. Neither bill passed. However, the bills generated both Legislative and Executive branch interest; and the Milbank Memorial Fund, a nonpartisan foundation that works with states on health policy issues, has agreed to convene a roundtable discussion among stakeholders on the PBM regulation issue early in the 2005 session.

Drug Importation

Drug importation has received considerable attention, with numerous states and localities announcing their intention to assist their citizens with buying drugs from Canada and other countries. According to the Congressional Budget Office, brand name drug prices are estimated to be as much as 35 to 55 percent lower in Canada than in the U. S. The federal Food and Drug Administration (FDA) has consistently opposed drug importation due to safety and counterfeiting concerns. However, the Medicare Modernization Act permits importation from Canada if the U. S. Department of Health and Human Services can certify the safety of the drugs. The Act also requires the Secretary to conduct a study on importation of drugs and submit the study to Congress by December 8, 2004. The Secretary has charged the Surgeon General with the report, which is expected in November 2004.

In Maryland, Senate Bill 167 of 2004 would have required the Secretary of Health and Mental Hygiene to apply for a federal waiver to permit the State to purchase drugs from Canada for State employees and retirees, Medical Assistance enrollees, and others. The bill did not pass. At the local level, the Montgomery County Council passed a resolution in September 2004 urging county agencies to provide their employees and retirees an option of safely ordering FDA-approved prescription drugs from Canada at a significantly reduced cost.

Price Controls

Maine was the first state to enact price control legislation in 2000. The Maine law allowed the state to review maximum retail drug prices and establish maximum retail drug prices for new prescription drugs. The law has been tied up in the courts and has not been implemented. West Virginia is examining price controls under its Pharmaceutical Availability and Affordability Act passed in 2004. Other states have introduced legislation to impose price controls, but none have adopted it.

Medicare Prescription Drug Benefit

The Medicare Modernization Act of 2003 establishes a new prescription drug benefit for Medicare enrollees, beginning January 1, 2006. The new federal benefit will require the General Assembly to make decisions at the 2005 session regarding related State programs.

Medicaid, Maryland Pharmacy Assistance, and Maryland Pharmacy Discount Programs

DHMH reports that of the 200,000 fee-for-service recipients enrolled in Medicaid, the Maryland Pharmacy Assistance Program, or the Maryland Pharmacy Discount Program, approximately 100,000 are eligible for Medicare. Under the Medicare Modernization Act, most of these 100,000 recipients will be offered subsidies to cover premiums, deductibles, and co-payments. The State is responsible for outreach to dually eligible individuals and helping them enroll in a Medicare prescription drug plan.

The future of the Pharmacy Assistance and Pharmacy Discount programs is still unclear. The Pharmacy Assistance Program provides prescription drugs to individuals with income below 116 percent of federal poverty guidelines. Enrollees pay only a modest co-payment. The Pharmacy Discount Program provides prescription drugs to elderly individuals with income between 116 and 175 percent of federal poverty guidelines. Enrollees pay 65 percent of the Medicaid price plus a $1 processing fee for their drugs, with Medicaid subsidizing the remaining 35 percent. Since 2002, these two programs have operated under a federal Medicaid waiver, with the federal government paying half the cost (approximately $42 million). DHMH expects the federal government to withdraw the waiver once the new Medicare drug benefit begins.

The State will need to decide the future of these programs. DHMH has applied for a federal waiver that would provide coverage for primary care, including prescription drugs, for Pharmacy Assistance recipients. As of November 2004, the federal government has not yet made a decision on the application. The Pharmacy Discount Program only has about 4,000 enrollees, and most of them will receive a subsidized Medicare benefit. Only individuals with income between 150 and 175 percent of federal poverty guidelines will not receive a subsidy.

Senior Prescription Drug Program

Another program affected by the new Medicare drug benefit is the Senior Prescription Drug Program, administered by CareFirst, under the direction of the Maryland Health Insurance Plan. The program is open to Medicare beneficiaries with income at or below 300 percent of federal poverty guidelines. Enrollees pay a monthly premium of $10, pay a co-payment ranging from $10 to $35, and have a total annual benefit of $1,100 in fiscal 2005. The program is subsidized by CareFirst, up to the value of its 2 percent insurance premium tax exemption. By law, the program will terminate on the earlier of June 30, 2005, or the availability of comparable prescription drug benefits provided by Medicare.

Like DHMH programs, Senior Prescription Drug Program enrollees with income up to 150 percent of federal poverty guidelines will receive a subsidized Medicare drug benefit. Depending on their prescription drug needs, enrollees with higher incomes may receive a better benefit through the Senior Prescription Drug Program than under Medicare. The Maryland Health Insurance Plan Board is considering legislative options to, at minimum, continue the program until January 1, 2006; and after January 1, 2006, continue to provide some form of subsidy for prescription drug coverage.

As of June 2004, Senior Prescription Drug Program enrollees with income up to 135 percent of federal poverty guidelines also qualify for a $600 annual transitional subsidy under Medicare. Other states that operate state-funded pharmacy assistance programs have enrolled their low-income Medicare beneficiaries in a Medicare discount card program to take advantage of the $600 subsidy and help defray the cost of the state-funded program. The Maryland Health Insurance Plan has informed Senior Prescription Drug Program enrollees about the availability of the $600 subsidy but has not been as aggressive as some other states in ensuring that enrollees exhaust the $600 subsidy before using the state-funded program.

In October 2004, Maryland was awarded a $1.7 million federal grant to educate low-income Medicare beneficiaries, who currently get their prescription drugs through State-funded programs, about the new Medicare drug benefit. The Maryland Health Insurance Plan applied for and received the grant on behalf of the Senior Prescription Drug Program. Funds will be used for outreach and education about the options available under the new Medicare benefit.

Conclusion

The General Assembly will likely revisit options such as PBM regulation and drug importation to contain the rising cost of prescription drugs. The new Medicare drug benefit will make available resources that the General Assembly may want to dedicate to a prescription drug subsidy for low-income elderly or nonelderly individuals. According to the Rutgers Center for State Health Policy, most state pharmacy assistance programs plan to continue some low-income drug coverage in 2006. Options being considered include:

- paying all or a portion of the Medicare premium;
- subsidizing Medicare cost sharing;
- providing coverage to ameliorate or fill the Medicare “donut hole” (costs between $2,250 and $5,100, paid entirely by the enrollee, unless low-income);

- providing coverage for drugs that may not be on the Medicare drug plan formulary; and
- covering out-of-network pharmacies.

Health and Health Insurance

Medical Malpractice Insurance Reform and Patient Safety

States nationwide are grappling with the issue of a lack of affordable and available medical professional liability insurance. The issues involved are varied, but the topic has brought back into focus efforts to improve patient safety.

Overview

According to many experts, the United States is experiencing its third medical malpractice crisis in the last 30 years. In some parts of the country, medical professional liability insurance has become both unaffordable and unavailable, especially for physicians practicing in high-risk specialties such as obstetrics, neurosurgery, and orthopedic surgery.

The burden of the higher cost of medical professional liability insurance falls on health professionals and facilities. During the second malpractice crisis in the 1980s, health care providers responded to sharply rising liability premiums by passing the cost on to public and private payers. Since then, the advent of managed care in commercial markets has limited a provider's ability to pass on increased rates as a cost of business.

Medical Professional Liability Insurance in Maryland

Depending on the specialty and the state, the median increase in malpractice premiums ranged from 15 to 30 percent in 2003, with some states (*e.g.*, Pennsylvania) experiencing higher rate increases of 26 to 73 percent. Initially unaffected by the medical malpractice crisis, Maryland health care professionals and institutions began experiencing sharp rate increases in 2003. The State's largest medical professional liability insurer, the Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), received approval from the Maryland Insurance Administration (MIA) for a 28 percent premium rate increase effective January 1, 2004, and a second rate increase of 33 percent effective January 1, 2005. These increases prompted consideration of various insurance reform proposals:

- creation of a reinsurance fund or patient compensation fund to allow medical professional liability insurers to freeze rates at 2004 levels;

- implementation of rate compression to decrease the insurance costs for certain high-risk specialties by increasing insurance costs for lower-risk physicians;

- reducing insurance producer commissions on the issuance of new and renewal medical professional liability insurance policies;

- increasing the Maryland Medical Assistance Program fee-for-service specialty physician rates and capitation payments to managed care organizations;

- expanding the Good Samaritan statute to include all health care professionals that provide care under the federal Medical Treatment and Active Labor Act; and

- requiring insurers to report certain medical malpractice claim information to MIA.

Although medical professional liability insurance rate increases are at the forefront of the medical malpractice debate, a discussion of patient safety initiatives and reforms is also receiving increasing attention on both the State and national level.

The Patient Safety Element of Medical Malpractice Reform

Since the issuance of the Institute of Medicine's report, *To Err is Human, Building a Safer Health System,* in November 1999, national attention has focused on patient safety and reducing errors in the health care system. Medical errors resulting in a patient's injury or death have occurred as a result of systemic hospital failure. These medical errors have ranged in severity from confusion between two patients with similar names but admitted for different procedures to failure to confirm the blood type of a patient prior to performing a heart transplant. Medical errors resulting in a patient's injury or death have also been attributed to poor or illegible handwriting on a prescription and the inability of the State licensing board to adequately discipline "bad" doctors.

As an attempt to address systemic problems within the hospital setting, legislation enacted in 2001 required the Maryland Health Care Commission to study the feasibility of developing a system for reducing incidences of preventable adverse events in Maryland. The Maryland Patient Safety Center was established on June 18, 2004, as a result of the study. The center is jointly administered by the Maryland Hospital Association and the Delmarva Foundation. Using the Veterans Health Administration's model for improving patient safety, the center will host a confidential data repository for reporting of errors and near misses in the delivery of health care. The center also will facilitate education and collaboration among health care providers. The Maryland Patient Safety Center is seen by many as a proactive development in the effort to prevent medical errors.

Another patient safety related issue that has received renewed attention is physician discipline. Prompted by the sunset review of the State Board of Physicians (formerly known as the Board of Physician Quality Assurance), a debate has examined whether the standard of review by which physicians are judged should remain as "clear and convincing evidence" or be lowered to require only a "preponderance of the evidence" as is consistent with the other State health occupations boards. The law currently provides that, for cases involving an evaluation of the standard of care exercised over a patient, the standard of review is clear and convincing evidence; however, for other actions (such as failure to comply with the Centers for Disease Control guidelines) the standard of review is preponderance of the evidence.

Other patient safety reforms being considered include:

- strengthening the enforcement authority of the Department of Health and Mental Hygiene to fine hospitals that fail to report adverse events;

- increasing the penalty for practicing medicine without a license from a misdemeanor to a felony;

- integrating health care service delivery with information technology (see the paper on Healthcare Information Technology in this section for a further discussion);

- requiring courses regarding bedside manner and identification and prevention of medical errors as a condition of licensure for certain health care practitioners; and

- enhancing online physician profiles relating to recorded medical malpractice claims and judgments against physician licensees.

Conclusion

Despite the American Medical Association classification of Maryland as a "state showing problem signs" rather than as a state in actual crisis, State leaders are actively working on a solution to the medical malpractice professional liability insurance issue. Any solution is likely to be one that addresses multiple concerns of the practicing physicians who are subject to the increases in liability premiums; the insurance industry that is responsible for both justifying the increase in premiums and making payments to victims; the victims who have been harmed by either a physician or a hospital; the attorneys who bring suit on behalf of these victims; and consumers of health care who may face difficulty finding a physician willing to treat a high-risk pregnancy, disease, or injury.

For further discussion on medical malpractice tort issues see the "Medical Malpractice Tort Issues" paper under the Civil Proceedings section of this book.

Health and Health Insurance

Cigarette Restitution Fund Spending

In fiscal 2007 and again in fiscal 2008, the Cigarette Restitution Fund (CRF) is likely to see an increase of available dollars. This increase presents the General Assembly with an opportunity to provide direction as to how CRF dollars should be used.

Background

The Cigarette Restitution Fund (CRF) was established by Chapter 173 of 1999 in anticipation of revenue from the Master Settlement Agreement (MSA), a landmark settlement between the major tobacco companies and the attorneys general of 46 states worth more than $200 billion. Each state's share of settlement funds was determined by a formula that assigned equal weight to Medicaid and non-Medicaid smoking-related costs. According to this formula, Maryland will receive 2.26 percent of MSA monies, resulting in variable annual payments of $150 to $200 million.

Since fiscal 2001, Cigarette Restitution Funds have been used for a variety of programs, most health- and tobacco-related. The General Assembly established nine health- and tobacco-related priorities that have guided spending decisions. To support these priorities, the General Assembly established two programs to address the causes and effects of tobacco use. These programs, the Tobacco Use Prevention and Cessation Program and the Cancer Prevention, Education, Screening, and Treatment Program, are the foundation of the Cigarette Restitution Fund program. Administered by the Department of Health and Mental Hygiene's Family Health Administration, the programs make funds available to local health departments and academic health centers for local tobacco intervention, media campaigns, cancer screening and treatment, and tobacco- and cancer-related research.

Spending Requirements

According to Section 7-317 of the State Finance and Procurement Article, the Governor must include the lesser of $100 million or 90 percent of available Cigarette Restitution Funds in the annual budget; furthermore, at least 50 percent of appropriations from the fund must be dedicated to the health-related priorities established by law. Annual appropriations have met this threshold, with an increasing percentage of funds dedicated to health-related programs in recent years. Education funding, which comprised a significant proportion of appropriations in the nascent years of the Cigarette Restitution Fund program, is now supported with alternate funding sources, leaving funding concentrated in four areas: the tobacco program, the cancer program, Medicaid, and substance abuse treatment. This trend is detailed in **Exhibit 1**. This commitment distinguishes Maryland from other states, an increasing number of which are using tobacco settlement revenue to cover budget shortfalls.

Exhibit 1
Cigarette Restitution Fund Spending
Fiscal 2001 – 2005
($ in Millions)

	Fiscal 2001 Actual	Fiscal 2002 Actual	Fiscal 2003 Actual	Fiscal 2004 Actual	Fiscal 2005 Appropriation
Tobacco	$7.3	$16.9	$19.6	$13.8	$9.5
Cancer	23.8	34.6	37.2	30.8	30.4
Medicaid	24.6	0.0	104.0	108.3	50.5
Substance Abuse	16.3	16.9	18.5	17.1	17.1
Other	58.4	50.6	22.1	8.9	9.1
Total	**$130.4**	**$119.0**	**$201.4**	**$178.9**	**$116.6**

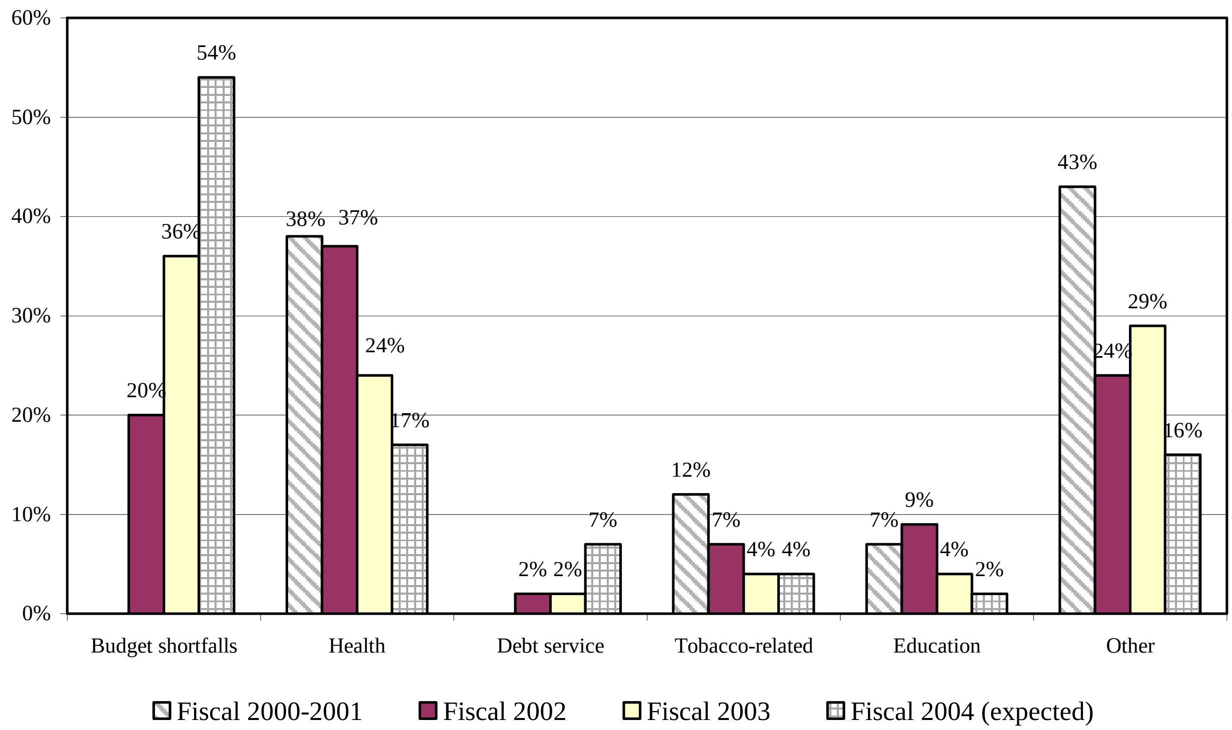
Source: Department of Budget and Management; Department of Legislative Services

Maryland's Use of MSA Payments Compared to Other States

MSA allows states to use their tobacco settlement payments for any purpose. Although there is no mandate regarding the usage of funds, many State officials claimed a commitment to use the funds to treat smoking-related illnesses. However, since the initial receipt of funds, many states have altered priorities for funding.

The General Accountability Office (GAO) is required by federal law to report annually on payments made by tobacco companies and the states' use of these funds. As detailed in **Exhibit 2**, GAO tracked states' use of MSA payments as broadly falling into six categories: budget shortfalls; health programs; debt service on securitized funds; tobacco-related programs, including economic development for tobacco-dependent regions and tobacco control; education; and other. The most recent GAO report, released in March 2004, found that the portion of funds that states allocate to budget shortfalls has increased while funding for health programs has decreased.

Exhibit 2
State Allocation of Tobacco Settlement Revenue



Note: In fiscal 2000 to 2001, no funding was expended on budget shortfalls or debt service.

Source: General Accounting Office

When compared to other states, the following points can be made about the way Maryland has spent its MSA payments:

- Use of these payments to cover budget shortfalls is well below the national average. In fiscal 2003, Maryland distributed Cigarette Restitution Funds in the following manner: 56 percent for health; 11 percent for general purposes; 9 percent for tobacco-related programs; 5 percent for education; 1 percent was for budget shortfalls; and 18 percent was unallocated. In the same period, nine states used more than 50 percent of their MSA payments for budget shortfalls, nine states used less than 50 percent of their MSA payments for budget shortfalls, and 27 states did not use any of their MSA payments for budget shortfalls. One state allocated 100 percent of its MSA payments to budget shortfalls.

- Although the amount of available revenue declined significantly in fiscal 2004, Maryland continues to use the majority of its MSA payments for health programs. The same is not true for most states.

- Although there is no mandate on the use of MSA payments, the Centers for Disease Control and Prevention (CDC) recommends that states use 20 to 25 percent of MSA payments for smoking prevention programs. For Maryland, CDC recommends that the State spend between $30 and $79 million to have an effective, comprehensive tobacco prevention program. Maryland ranks thirteenth among states in funding for smoking prevention and has allocated $9.5 million in Cigarette Restitution Funds and $2.5 million from other sources for this purpose in fiscal 2005. However, this is only 40 percent of the CDC's minimum recommendation.

Additional Funding Will Likely Be Available from the Cigarette Restitution Fund in Fiscal 2007 and Again in Fiscal 2008

Additional funding will be available to the CRF in future years as the State's legal obligations expire and settlement payments increase. The State will pay the last of five installments to the Law Offices of Peter G. Angelos, P.C. in fiscal 2006, making an additional $30 million available to the CRF in fiscal 2007. Additionally, the State will begin to receive strategic contribution payments beginning in fiscal 2008 and continuing through fiscal 2017. These payments, which are based on states' legal contributions to the tobacco settlement, will increase the funds available to the State by an estimated $28 million each year.

Priorities for additional revenue may include the following:

- ***Tobacco Use Prevention and Cessation Program:*** The current program is underfunded according to CDC guidelines. Fiscal 2005 funding for the program is over $10 million below the levels of fiscal 2003. Programs in other states have been successful in significantly lowering smoking rates, especially among youth. The Maryland program does not have the resources to fully implement all components of a successful program. A larger investment in this program has the potential to produce significant long-term improvements in public health while also reducing State medical costs.

- ***Breast and Cervical Cancer Program:*** This program, administered by the Family Health Administration, supports breast and cervical cancer screening, diagnosis, and treatment for women with incomes below 250 percent of the federal poverty level. Both of these cancers are among the seven targeted cancers established in the CRF statute. This is an established program currently receiving limited support from the CRF; additional support would be consistent with the goals of the Cigarette Restitution Fund program and would relieve pressure on the general fund.

- ***Medicaid:*** Medicaid costs are increasing at a rate which crowds out spending for other general fund programs. As tobacco settlement revenue was designed to compensate states for a portion of their smoking-related Medicaid costs, the General Assembly may want to consider directing additional funds to this program. Alternatively, there may be efforts to expand Medicaid coverage (or access to health care generally) through this new funding source.

The 2005 session provides the General Assembly with the opportunity to assert its spending priorities for the CRF. The availability of additional funding also provides an opportunity to evaluate existing programs to determine if they meet the objectives of the General Assembly in reducing tobacco use, cancer mortality, and otherwise improving public health of residents of the State of Maryland.

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Health and Health Insurance

Medicaid Enrollment and Funding Trends

In recent years, Medicaid costs have risen above the rate of general fund revenues and as a consequence have consumed a greater share of the State budget. That trend is forecast to continue in fiscal 2006.

Overview

Maryland's Medicaid and Children's Health Programs provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50 percent for Medicaid and 65 percent for the Maryland Children's Health Program (MCHP). Most Medicaid/MCHP recipients are required to enroll with a managed care organization (MCO).

Medicaid accounts for about 15 percent of State general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, Medicaid costs are expected to rise at a rate of about 8 percent annually while general fund revenues are forecast to grow at a 5 percent clip. As a result, spending pressure from Medicaid, unless somehow abated, will have the effect of "crowding out" spending for other purposes.

Fiscal 2005 Outlook

When the General Assembly completed deliberations on the fiscal 2005 budget, a combined Medicaid/MCHP deficit of about $30 million of general funds was forecast. The Department of Legislative Services (DLS) now anticipates a shortfall of $95 million in general funds.

A myriad of unfavorable events contribute to the bleak outlook for Medicaid finances, most significantly actual fiscal 2004 expenses exceeding estimates. With the fiscal 2004 appropriation exhausted, the State will pay the remaining bills for fiscal 2004 services with fiscal 2005 dollars ($25 million of general funds). Additional general funds are also required to address the development of the fiscal 2005 budget off the understated fiscal 2004 base ($25 million), an unbudgeted rate increase for MCOs in calendar 2005 ($23 million of general funds), a shift in responsibility for certain Medicaid eligible nursing home residents from the District of Columbia to Maryland ($7 million), and unfavorable changes in utilization and inflation ($15 million). Final fiscal 2005 expenditures are expected to exceed actual fiscal 2004 costs by about 7 percent as cost containment savings moderate the impact of medical costs (7 percent) and enrollment (2 percent).

Fiscal 2006 Outlook

For fiscal 2006, combined Medicaid and MCHP expenditures of $4.2 billion are anticipated, of which almost half will be general funds (**Exhibit 1**). General fund spending is expected to grow by about $162 million or 8 percent over projected fiscal 2005 costs. Expenditure growth of about 8 percent is forecast as increases in enrollment (2 percent) and medical costs (7 percent) are partially offset by the savings generated by shifting Medicare enrollees from the Maryland Pharmacy Assistance Program to the new Medicare drug benefit on January 1, 2006. Enrollment growth is spurred by a steady rise in the number of children qualifying for Medicaid due to their low incomes and by the removal of impediments to MCHP enrollment imposed for fiscal 2004 only. The forecast for fiscal 2006 rests on a number of necessarily imperfect assumptions including:

- ***Hospital Day Limits:*** Medicaid regulations currently limit the number of days of hospital coverage for adults to 105 percent of the average length of stay by diagnosis-related groups. The DLS forecast assumes the day limits continue in fiscal 2006 producing general fund savings in excess of $20 million. However, this cost containment action is scheduled to sunset at the close of fiscal 2005.

- ***Long-term Care Reform:*** The Department of Health and Mental Hygiene plans to implement a system of managed long-term care during calendar 2006. The DLS forecast assumes implementation begins in January 2006 but anticipates net savings of only about $2 million in fiscal 2006. Minimal savings are anticipated for the first year of the initiative as start-up costs will offset most of the savings generated by a projected 1 percent reduction in medical costs. Delays in implementation could result in costs exceeding savings in fiscal 2006. Conversely, the initiative will achieve greater savings than projected if medical costs are reduced by more than 1 percent.

- ***Utilization of Services:*** Utilization of medical care by disabled enrollees accelerated at startling rates in fiscal 2004. The number of physician services, hospital visits, and prescriptions per disabled fee-for-service enrollee all rose at rates in excess of 14 percent. The DLS forecast assumes a return to single-digit growth rates for fiscal 2005 and 2006.

- ***Medicare Clawback Provision:*** The federal Medicare prescription drug law shifts responsibility for purchasing pharmaceuticals for individuals who are dually eligible for Medicaid and Medicare from Medicaid to Medicare in January 2006. To minimize the fiscal impact on the federal government, states are required to contribute an amount equal to the federal estimate of the costs that would have been incurred by each state less a discount (10 percent in calendar 2006). To calculate the calendar 2006 State contribution, the federal government will apply a trend factor to each state's calendar 2003 per capita Medicaid spending on prescription drugs for the dually eligible.

  The DLS forecast assumes Maryland's Medicare contribution will equal the costs Maryland would have incurred to purchase the drugs through Medicaid. However, the

State could experience higher costs or realize savings depending on the trend factors used by the federal government. If the trend factors do not adequately reflect Maryland's recent efforts to constrain prescription drug costs, the State payment to Medicare may exceed the costs that would actually have been incurred by Medicaid. Trend factors consistent with Maryland's actual experience, in contrast, would produce a windfall for the State.

Exhibit 1
Enrollment and Service Year Expenditures*
($ in Millions)

	FY 2004 Actual	FY 2005 Approp.	FY 2005 Estimate	FY 2006 Estimate	% Change FY 2005-06
Enrollment by Category					
Medicaid	502,910	523,000	515,052	523,533	2%
MCHP	97,564	98,400	102,442	107,564	5%
Total	**600,474**	**621,400**	**617,494**	**631,097**	**2%**
Cost per Medicaid/ MCHP Enrollee	$6,138	$6,054	$6,337	$6,714	6%
Total Funds	**$3,686**	**$3,762**	**$3,923**	**$4,237**	**8%**

*Expenditures by fiscal year are based on the costs of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Maryland Pharmacy Assistance Program and the Maryland Pharmacy Discount Program are excluded from the chart.

Source: Department of Legislative Services

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Health and Health Insurance

Drug Treatment

Funding for substance abuse treatment has increased significantly in recent years. Despite this increase, the treatment system remains fragmented. This fragmentation limits the overall efficacy of treatment services.

Background

The publicly funded substance abuse treatment system has received increased attention in recent years for its potential to improve a variety of social outcomes. Significant funding increases have been committed to the system with the intent of improving the overall health and well-being of Maryland citizens while reducing criminal activity and increasing rates of employment.

Funding for the Alcohol and Drug Abuse Administration (ADAA), the primary provider of treatment services, increased 79 percent from fiscal 2000 to 2005 ($74 million to $133 million), and more people are being treated (44,955 in fiscal 2000 compared to an estimated 53,973 in fiscal 2005). The number treated has not increased at the same rate as increases in funding, owing to several factors: significant increases in the cost of certain treatment modalities, increases in the length of time in treatment, and insistencies in fiscal 2000 data reported by ADAA.

Although funding has increased significantly, new resources have been applied to an outdated treatment model. Treatment still varies by point of access, whether it is the criminal justice system, the mental health system, or the local health department. Treatment also varies by jurisdiction, with each of the State's 24 health departments designing and implementing its own treatment system.

Significant problems have developed in the treatment system, many related to agency and service coordination. In many cases, recent growth has exacerbated existing problems as a relatively static set of internal resources has been spread among a growing set of programs. Foremost among concerns remains the fragmentation of the treatment system. The current budget structure encourages each of the eight State agencies that provide substance abuse treatment to operate independently, even though an individual may access services from multiple agencies over the course of a treatment episode.[1] This fragmentation reduces comprehensive oversight, making it difficult to assess precisely what the State is buying with treatment funds.

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[1]Agencies with responsibility for substance abuse treatment include the Alcohol and Drug Abuse Administration, the Mental Hygiene Administration, the Medical Care Programs Administration, and the AIDS Administration within the Department of Health and Mental Hygiene; the Department of Human Resources; the Department of Juvenile Services; and the divisions of Correction and Parole and Probation within the Department of Public Safety and Correctional Services.

Concerns for the Treatment System

The fragmentation of the treatment system has created or exacerbated problems in the delivery of substance abuse treatment. These concerns include the following.

Co-occurring Conditions Receive Inadequate Attention

Common among individuals seeking treatment from the publicly funded system are conditions which affect the course and likely success of treatment. These include homelessness, lack of medical care, chronic medical conditions, or a long history of substance abuse. Often these contributing factors are not addressed. Alternatively, when they are, it is often independent of the treatment program. Nowhere is the divide more evident than in the diagnosis and treatment of those individuals with concurrent mental illness and substance dependence.

Treatment for this population in the publicly funded system is largely determined by an individual's point of access to the system and the severity of the mental illness. Most dually diagnosed individuals receive substance abuse treatment by entering the mental health system; an estimated 80 percent of those dually diagnosed are treated by the Mental Hygiene Administration (MHA), straining existing resources in that system. In addition, those with severe mental illness are most often treated by MHA, regardless of the severity of their addiction.

Diagnosis and appropriate care of individuals with co-occurring disorders are complicated by the lack of standard assessment and treatment protocols. There is no single standard evaluation conducted of individuals entering the mental health or the treatment systems. In addition, providers are often not trained in evaluation and treatment of both disorders, making care responsive to both disorders scarce.

Gender-specific Treatment Is Largely Unavailable

Women comprise approximately one-third of treatment admissions in Maryland, mirroring national treatment admission rates. Women admitted to ADAA programs are more likely than men to abuse multiple substances, suffer from mental illness, have dependent children, and be unemployed. These factors contribute to a reduced likelihood that a woman entering the system will complete treatment.

Research suggests that gender-specific treatment programs contribute to retention in, and completion of, treatment. These programs are designed specifically to address issues that disproportionately affect women, such as domestic violence and sexual abuse, as well as to provide services to encourage retention, such as child care. Research suggests that such programs are correlated with improved treatment outcomes, such as lower rates of relapse, increased job stability, and maintenance of child custody.

Several programs operated jointly by the Department of Human Resources (DHR) and ADAA are designed specifically to identify women and families in need of treatment. These programs have increased the demand for treatment slots for women with children, often leading to waiting lists for these slots (although ADAA has not been able to quantify how many people are on waiting lists at any given time). Encouraging providers to create more capacity for women and their children would contribute to improved outcomes for these programs and for women generally.

Program Implementation Is Not Integrated

Several programs established by the General Assembly attempt to improve access to substance abuse treatment for women and families in need. These programs, implemented jointly by DHR and ADAA, include the Substance Abuse Treatment and Services Program, designed to identify and provide treatment for Temporary Cash Assistance adults and certain food stamp recipients, and the Integration of Child Welfare and Substance Abuse Treatment Services Program that attempts to identify and treat substance using adults in homes with vulnerable children. These programs rely on training of existing personnel and additional addictions counselors to identify and refer clients to treatment. Although there is significant overlap in the clients served and services provided, these are administered as separate programs, in accordance with State law.

Distinctions among programs present additional concerns at the clinical level. The programs mentioned above, along with the Drug Exposed Infants Program, another collaborative effort between DHR and ADAA, each purchase slots for individuals referred by their programs. Even though there is significant overlap in the constituencies for these three programs, slots are purchased and managed separately, creating inefficiencies in resource management. An individual in need of treatment may have to wait for a treatment slot specifically reserved for that program, even when vacancies exist elsewhere. The restrictions on these treatment programs make it more difficult to place an individual in the appropriate level of treatment in a timely manner. These programs may be able to make progress toward treatment on demand, increasing enrollment in treatment, if some of the administrative barriers that separate programs were eliminated and funding streams were consolidated.

Similarly, while ADAA has begun to report more accurate and complete client data, the data does not span different agencies making outcome data less useful than it might. At this point, other agencies lag behind ADAA in collecting and quantifying treatment outcomes.

Local Programs Vary Widely in Services Offered

Each of the State’s 24 jurisdictions designs its own substance abuse treatment model. Often, the treatment options available in a given jurisdiction are based on how services have been offered historically. ADAA has increased the availability of technical assistance, improving local health departments’ access to best practices suggested by the scientific literature; however, treatment gaps remain. Certain jurisdictions provide limited treatment options, reducing the probability that an individual in need of treatment will receive the appropriate level of care. In many instances, jurisdictions are still learning to anticipate demand and use outcome data to develop a comprehensive treatment model.

Chapters 237 and 238 of 2004 established local drug and alcohol councils, including representatives of health, social services, criminal justice, and education interests to develop a plan for meeting the local need for drug abuse evaluation, prevention, and treatment services. This new administrative structure will provide localities with an opportunity to reassess currently offered options and will require submission of a strategic plan for providing treatment. Local plans, due in July 2005, will provide ADAA with additional opportunities to provide input into local processes.

Data Sharing Is Limited Across Agencies

ADAA recently implemented the eSAMIS program, a web-based data management system to assist in case management, collection of admission and discharge data, and improve access to treatment availability data. All treatment providers are now required to report admission and discharge data electronically. With this system, ADAA has improved its ability to provide timely individual and aggregate data.

Despite these improvements, data sharing among agencies remains minimal. DHR, which operates several programs in collaboration with ADAA, currently receives aggregate program data but does not receive individual treatment statistics. This closed feedback loop does not allow the department to sanction those who do not complete treatment, as required by law, and reduces accountability among agencies. It also reduces the input that DHR staff have in program or clinical treatment decisions related to their clients.

Looking Forward

An integrated treatment system that addresses the concerns raised above has the potential to increase access to treatment, improve outcomes, and create administrative efficiencies. It would also facilitative evaluation of the effectiveness of State-supported treatment. The disparate elements of the current system make it difficult to provide a single answer to the question of what the State is buying with substance abuse treatment funding. A State Drug and Alcohol Council, established by executive order in July 2004 to promote coordination among State programs, local health systems, and private providers of substance abuse treatment, has the potential to provide oversight to a heterogeneous system, increasing accountability among agencies, the Administration, and the General Assembly.

As the General Assembly continues to increase funding for the publicly funded substance abuse treatment system, attention should focus on policies designed to decrease fragmentation and coordinate oversight. Specific areas in need of improvement include coordinating services for individuals with co-occurring disorders and encouraging providers to increase capacity for women and their children. In addition, possible programmatic improvements involve eliminating administrative barriers that separate treatment programs, establishing effective and accountable local plans, and improving data sharing among State agencies. Such improvements should result in cost savings and could allow the dedication of savings to additional areas of the treatment system such as prevention and evaluation.

Health and Health Insurance

Mental Health Funding

After years of escalating costs and a series of one-time budget fixes to remedy deficits, there is finally some evidence that the structural imbalance in the community mental health fee-for-service system has been addressed. However, this solution comes too late to offset the need for yet more one-time funding. In addition, past problems with the claims system are coming back to haunt the State and also require one-time funding.

Background

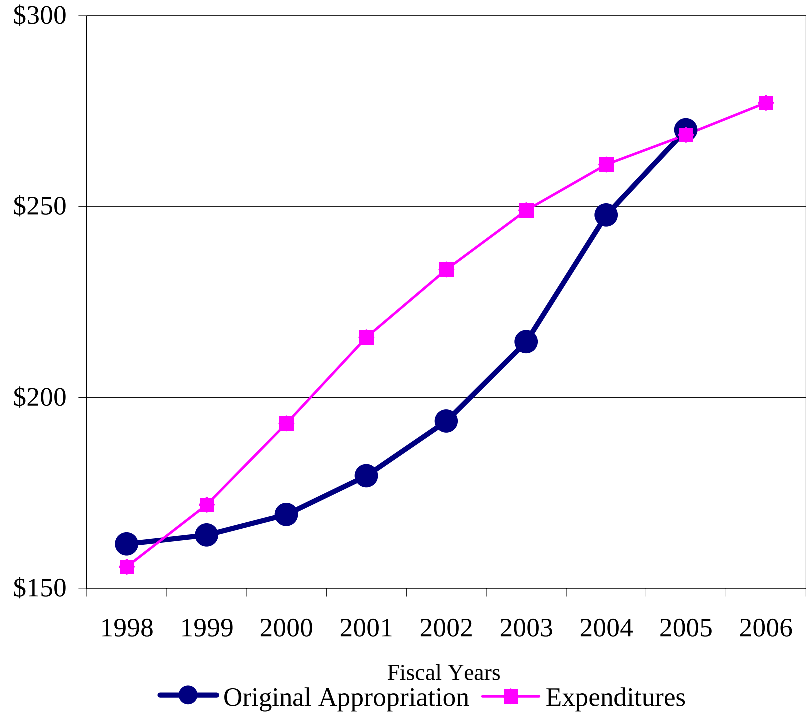
Beginning in fiscal 1998, specialty mental health services were carved out of the Medicaid program and provided largely through a fee-for-service system. Specialty mental health services are defined using accepted diagnostic criteria and delivered in a variety of settings including private doctors' offices, outpatient mental health clinics, psychiatric rehabilitation programs, and hospitals. Specialty mental health services are available to Medicaid clients and also to non-Medicaid-eligible clients with incomes up to 116 percent of Federal Poverty Guidelines (*e.g.*, $10,800 per year in 2004 for an individual).

The Structural Deficit in Community Services Funding

Since the 2001 session, the focus of discussion on the community mental health services program has been the structural imbalance between the available appropriation and actual expenditures. As shown in **Exhibit 1**, the imbalance first appeared in fiscal 1999. By fiscal 2001 and 2002, expenditures reached as much as 17 percent above the available appropriation.

A number of one-time actions have closed the structural gap, such as funding derived from a Tax Amnesty Program, the use of higher-than-anticipated disproportionate share payments, and deficiency appropriations. Until fiscal 2004, despite numerous cost containment proposals, there was little sign that the structural gap was closing; in fiscal 2005 it appears that the community mental health services budget is finally balanced. This balance is due to a combination of healthy increases in the available general fund appropriation (15.5 percent in fiscal 2004, 9 percent in fiscal 2005) and a slowing in the growth of expenditures. The decline in the growth in expenditures is attributed to provider rate cuts imposed in February 2004.

Exhibit 1
Community Mental Health Services Fee-for-service Funding
General Funds
Fiscal 1998 – 2006
($ in Millions)



Note: Fiscal 2004 through 2006 expenditures are Department of Legislative Services' estimates.

Source: Department of Legislative Services; Department of Health and Mental Hygiene

One-time Fix Is Still Required for Two Outstanding Problems

While the longstanding concern about the structural imbalance in the fee-for-service budget appears to be resolved, the Department of Legislative Services (DLS) still anticipates the need for a significant deficiency appropriation in the upcoming session to offset two problems:

- An estimated $19.1 million in general fund payables were rolled into fiscal 2005. These payables represent prior year bills that will be charged to the fiscal 2005 budget for which there is no appropriation.

- At the end of fiscal 2004, just under $29.3 million in federal funds that had been reported as claimed in prior years were in fact not received from the federal government. While this amount is down from that reported at the end of fiscal 2003, and further collections may be forthcoming, a significant amount of claims from the early years of the system will never be collected. In its fiscal 2006 baseline budget, DLS assumes a deficiency of $15 million for this item, although the final amount is likely to be higher.

Conclusion

The community mental health services program still requires a substantial one-time infusion of funds to offset prior year deficits and the noncollection of previously claimed federal funds. The imposition of rate cuts at the beginning of 2004 appears to be slowing the growth in expenditures, and DLS anticipates only a modest 4 percent increase in expenditures in fiscal 2006. However, this expenditure growth reduction has not been without cost. Providers have indicated that a number of programs have made significant reductions or have closed down as a result of the rate cuts. The impact on clients is less certain, but some limitations on access to services must be considered likely.

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Health and Health Insurance

Healthcare Information Technology

Increased attention is being paid to integrating information technology into health care delivery. The promised benefits are large, the barriers significant. A review of federal and State efforts to reap those benefits is provided.

Background

The vision of a productive marriage between information technology (IT) and health care is an old one, dating back at least 40 years. Despite occasional surges of interest, the utilization of IT has yet to *transform* the delivery of health care services. However, in the past two years, there has again been significant policy discussion on the potential benefits of healthcare IT.

There is no common terminology for efforts associated with improving health care services through the use of IT. For the purposes of this paper, the phrase "Electronic Health Record" (EHR) will be used. An EHR is not simply an electronic medical record but encompasses such aspects as computerized physician order entry, a continuing care plan, as well as providing information for real-time financial transactions.

Why Adopt Such Technology?

The benefits of EHR include:

- Improved quality of care. EHRs are one of the major tools cited as a means to reduce medical errors and medically caused injuries and deaths (for example, through inadequate record availability and poor handwriting). The Institute of Medicine estimates that between 45,000 and 98,000 deaths per annum result from medical errors.

- Improved decision support through improved access to timely and appropriate treatment.

- Cost savings. One recent estimate of savings was $132 billion per year through, for example, reducing duplicative care, lowering health care administrative costs, avoiding errors in care, and increasing a focus on disease management.

- Interoperability and portability of records among different medical settings.

- Improved access to specialty information for the medically underserved.

- Better public health interventions through real-time disease monitoring as well as improved biomedical research by the same means.

- Increased consumer involvement through access to personal health records.

- Enhanced privacy. The privacy and security of EHRs could be an improvement over paper records, especially through the adoption of federal Health Insurance Portability and Accountability Act (HIPPA) security standards.

Barriers to Adoption

Given all the stated benefits for EHRs, it might be hard to understand why this technology is not being more widely embraced. It is estimated that EHRs are utilized in some form in 10 to 15 percent of all hospitals and 14 to 28 percent of all physician practices. A combination of financial, technical, legal, and cultural barriers has been identified as limiting the adoption of EHRs.

- Product and vendor immaturity. Few vendors have established track records of successful implementation in more than a few hospitals.

- Lack of resources. EHRs can cost $10,000 to $30,000 for a single practitioner (plus annual operating costs equal to 25 percent of system cost) to $20 million for a hospital-based system. One estimate of the cost for the development of EHRs nationwide is $276 billion.

- Lack of documented return on investment. Although there are numerous examples of the take-up of EHR (in one form or another), for example, in the Veteran’s Administration Veteran’s Health System, the body of evidence quantifying actual savings or other measures of success is still small.

- Inadequate financial incentives. Potential cost benefits accrue more to payers than the purchasers of IT systems. For example, reducing hospital savings from adverse drug events would not necessarily result in cost savings to physicians or hospitals.

- Lack of product certification and standards, including standard medical terminology. While there has been progress toward developing technical and nontechnical standards, until adopted there will inevitably be some reluctance to commit to one system over another.

- Lack of a cohesive federal policy. The federal government is the largest provider/purchaser of health care. However, until recently, it has shown little sign in being a major player in this debate.

- Lack of clinician involvement in system development results in reluctance to utilize technology by key players.

- Training demands and workplace changes. The use of EHRs profoundly changes workflow and, at least initially, can add time to current activities. Training requirements are substantial.

- Poor planning and implementation. For large health care providers, EHRs are like any major information technology project, requiring specific project planning and management skills that are often in short supply.

- Beyond the very real legal issues associated with health information privacy and security, a wide range of laws involving fraud and abuse, antitrust, tax, intellectual property, liability/malpractice, and licensing present barriers to adoption.

Overcoming Barriers to EHRs

Given the various barriers to EHRs, what are governments doing to overcome them? Efforts are underway at both the federal and State level.

Federal Healthcare Information Technology Initiatives

At the federal level, the need for integrated healthcare IT to improve national health care has received support from the Bush Administration and bipartisan support from Congress. In April 2004, President George W. Bush issued an executive order creating the position of the National Coordinator for Health Information Technology within the Department of Health and Human Services to coordinate and evaluate IT efforts and to establish technical standards to allow physicians and hospitals to share medical records while ensuring patient privacy. The order calls for the majority of Americans to have interoperable EHRs within 10 years.

In July 2004, the Secretary of Health and Human Services released a framework for strategic action entitled *The Decade of Health Information Technology: Delivering Consumer-centric and Information-rich Health Care*. The report outlines the Bush Administration's long-term health care information strategy. The Administration has allotted $50 million for electronic medical record projects in 2004 and $100 million in 2005.

Federal legislation related to healthcare IT has primarily focused on the need for federal investment to create a health information infrastructure and the necessary IT supports. For example, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 establishes a real-time electronic prescribing program for use by health care providers who serve Medicare beneficiaries and requires the Secretary to develop initial uniform standards for electronic prescribing. The Act also authorizes the Secretary to make grants to physicians to implement electronic prescription programs and provides some limited payments for physicians who agree to use healthcare IT.

Similarly, patient safety legislation that has passed both the House and Senate and is currently being reconciled also encourages the adoption of healthcare IT. The Patient Safety Improvement Act (H.R. 663) directs the Secretary to develop or adopt voluntary, national standards for the interoperability of healthcare IT systems within 18 months after enactment and provides for grants for practitioners to establish an electronic prescription drug program. The Patient Safety and Quality Improvement Act (S. 720) requires the Secretary to develop standards that promote the electronic exchange of health care information within 36 months of enactment and to assess the impact of medical technologies on patient safety and benefit.

Healthcare Information Technology Initiatives in Maryland

There is also movement within Maryland to develop a sustainable economic model for a healthcare IT infrastructure. The Maryland/D.C. Collaborative for Healthcare Information Technology (collaborative) is an independent group led by private practice physicians whose mission is to work collaboratively with Maryland and DC health care providers and organizations to improve quality of care, patient safety, and efficiency through healthcare IT. The primary objective of the collaborative is to implement a secure, HIPAA-compliant, regional database infrastructure to link all components in a health care delivery chain to appropriate and protected health information.

The collaborative's initial goal involves a five-year project to establish a community data exchange (CDE) infrastructure in Howard County that will make patient-focused health information readily accessible to authorized physicians. Interfaces from physician offices with EHR systems to CDE will be developed to allow for an exchange of patient information. Outcomes from the pilot project will allow the collaborative to examine the needed incentives for physician adoption, establish a sustainable business model, and outline plans for a data-sharing model to be used across Maryland within the next 10 years.

In April 2004, the collaborative was awarded a $100,000 planning grant from the Foundation for eHealth Initiative that will be used to establish a program office, set up a web site, and hire consultants. In addition, the collaborative is seeking funding from nonprofit foundations, rates provided to Maryland hospitals through the Health Services Cost Review Commission, and dues from stakeholders.

Healthcare Information Technology Initiatives in Other States

A number of healthcare IT initiatives have passed in other states while many more are under consideration. For example:

- ***Wyoming:*** The state enacted legislation requiring the Wyoming Health Care Commission to conduct a study on health information and communication technology.

- ***Rhode Island:*** The state enacted legislation establishing a Healthcare Information Technology and Infrastructure Development Fund (although without a specific revenue source) for the purpose of promoting the development and adoption of healthcare ITs.

- ***Florida:*** Governor Jeb Bush issued an executive order creating the Governor's Health Information Infrastructure Advisory Board to implement a strategy for the adoption and use of EHR and create a plan to promote the development of a Florida health information infrastructure.

- ***Tennessee:*** In July 2004, Governor Phil Bredesen announced the "Volunteer eHealth Initiative," a pilot project that will provide the framework for hospitals, physician groups, clinics, and health plans in three southwestern Tennessee counties to establish regional data-sharing agreements.

Conclusion

In its broadest sense, a fully integrated EHR system can benefit all stakeholders involved in health care delivery. However, a fully developed EHR system is years away and will require significant efforts to overcome the real barriers to full adoption. One recent study suggested that the current role for policymakers includes taking a leadership position on the need to improve patient safety through the adoption of healthcare IT; encouraging public and private payers to provide financial incentives to providers to adopt healthcare IT as a means of increasing patient safety; providing access to resources through loans or grants and encouraging interoperability by promoting standardization of vocabulary and communication protocols; and supporting research to fully understand the specific barriers that need to be overcome, including any specific state-level barriers. As shown above, there is evidence that policymakers are increasingly aware and interested in this issue.

Health and Health Insurance

Regulation of Hospitals and Laboratories

Problems with HIV and hepatitis test results at Maryland General Hospital have prompted concern about the current regulation of hospitals and laboratories. Legislation to improve oversight has been introduced at the federal level, and action in Maryland is expected at the forthcoming session.

Background

In March 2004, State officials announced that hundreds of patients at Maryland General Hospital had received possibly inaccurate HIV and hepatitis test results even though at the time the hospital's laboratory was accredited "with Distinction" by the College of American Pathologists. The Maryland General Hospital controversy raised the question of whether Maryland has enough oversight in the regulation of hospitals and laboratories.

Hospitals and laboratories are regulated by State and federal law. However, under both State and federal law, if hospitals or laboratories are accredited by certain organizations (primarily the Joint Commission on Accreditation of Healthcare Organizations, or JCAHO), they are "deemed" to have met certain standards and are not subject to certain licensure, inspection, and reporting requirements. This paper will give an overview of hospital and laboratory regulations in Maryland, at the federal level, and in other states.

Maryland Regulation

Licensure and Inspection

Under Maryland law, if a hospital is accredited by JCAHO, then the hospital is deemed to meet most State licensure requirements. Hospitals accredited by JCAHO are not subject to regular inspection by the State. Hospitals are only subject to State inspection in response to a complaint made to the State or to certain deficiencies found by JCAHO. Similarly, medical laboratories that are accredited by an organization approved by the Department of Health and Mental Hygiene (DHMH) meet most licensure requirements and are not subject to routine inspections by the State. DHMH has cited its lack of authority to inspect accredited facilities as a significant problem.

Access to Hospital Information

There is no legal requirement for the sharing of most information between the State and accrediting organizations of hospitals or laboratories. Hospitals accredited by JCAHO are required to submit JCAHO survey findings to the State within 30 days of the hospitals' receipt of those findings. However, there is no provision of law that allows the State to verify the findings of a JCAHO survey of a hospital. DHMH has expressed concern about its inability to obtain information from accrediting organizations or verify the findings of accrediting organizations.

Under Maryland law, most accreditation documents are not directly available to the general public. Marylanders may request, in writing, an accreditation letter from the hospital directly, and hospitals must make available the accreditation letter to the requestor within 15 working days.

Federal Regulation

Under federal law, hospitals accredited by JCAHO are generally deemed to be compliant with Medicare requirements for patient safety and health and are therefore eligible for payments from Medicare. In contrast, hospitals accredited by other organizations that meet the Center for Medicare and Medicaid Services' (CMS) standards are also deemed to be compliant with Medicare requirements but remain subject to direct review and approval by CMS. Currently, the American Osteopathic Association is the only other organization that accredits hospitals nationally.

There is some movement toward increasing regulatory oversight over JCAHO accredited hospitals at the federal level. A report published by the Government Accountability Office in July 2004 concluded that Congress should give CMS broader authority over JCAHO accredited hospitals. In response to this report, Congressman Pete Stark and Senator Charles Grassley introduced companion bills that would require JCAHO to be subject to the same oversight by CMS as other accreditation organizations.

Medical laboratories are required to be certified under federal law to operate. Laboratories may be deemed as meeting the certification requirements of the federal government only upon a determination that the accreditation organization meets certain requirements for inspections and standards.

Congressman Elijah Cummings recently introduced a bill that would provide whistleblower protections for employees of medical laboratories. The bill would also require that medical laboratories be subject to unannounced accreditation surveys.

Other States' Responses

New York

Since the 1980s, New York state law has required that hospitals and health clinics report to the state whenever they make errors that harm patients. However, an audit released in October 2004, found that New York hospitals often delay reporting information about errors, thereby frustrating state investigations. The audit also found that the state very rarely punished the hospitals for lapses in reporting.

Pennsylvania

In 2002, Pennsylvania created an independent state agency, the Patient Safety Authority (PSA), dedicated to reducing medical errors. Hospitals, birthing centers, and ambulatory surgical facilities are required to report all serious events and "near misses" to PSA, which collects and evaluates the data and makes recommendations to the health care facilities to prevent future errors. The data reported by the health care facilities is strictly confidential and is therefore not made public.

Utah

Utah deems accredited hospitals to be compliant with the state's licensure requirements, and accredited hospitals forego annual state licensure surveys. However, Utah retains the authority to attend hospitals' accreditation surveys. This allows Utah officials to learn of any deficiencies a hospital may have well before the issuance of the final accreditation report.

Conclusion

Regulation of hospitals and laboratories will most likely be addressed in the 2005 legislative session. DHMH has publicly stated its intention to introduce legislation that would increase the sharing of information between the State and accrediting organizations, as well as give the State broader authority to inspect accredited hospitals and laboratories.

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Health and Health Insurance

Medicaid Long-term Care Waiver

The Department of Health and Mental Hygiene is moving forward with a waiver application in order to restructure the delivery of long-term care services. However, many issues surrounding this application remain unresolved.

Background

The Department of Health and Mental Hygiene (DHMH) has recently begun an attempt to restructure the delivery of long-term care services in the State. According to DHMH, Medicaid growth for the long-term care population is not sustainable as 30 percent of the Medicaid budget is being allocated for 4 percent of Medicaid recipients. DHMH is seeking to contain the growth in long-term care Medicaid costs by implementing a managed care program called CommunityChoice to replace the current fee-for-service system. The program seeks to develop alternatives to institutionalized care, coordinate acute and long-term care services and financing with Medicare, control growth of long-term care costs, provide community-based services, and develop consumer-directed options.

Long-term Care Managed Care Legislation – 2004 Session

During the 2004 session, legislation was introduced to implement a long-term care managed care program. Senate Bill 819 would have required DHMH to apply for a waiver from the Centers for Medicare and Medicaid Services (CMS) to establish the CommunityChoice program, a managed care system to provide long-term care services to adults eligible for both Medicaid and Medicare, adult Medicaid recipients who meet the nursing home level-of-care standard, and Medicaid recipients over age 65. Program members would enroll in community care organizations (CCOs). The program would have operated in two areas of the State and terminated on May 31, 2008.

While DHMH initially supported the legislation, the department withdrew its support after amendments were adopted that would have (1) reimbursed nursing homes at the Medicaid or Medicare rate, adult day care centers at the Medicaid rate, and hospitals in accordance with rates set by the Health Services Cost Review Commission; (2) carved out hospice and specialty mental health services from the program; and (3) authorized individuals receiving services in certain facilities to continue receiving services in those facilities upon implementation of the program. According to DHMH, the cumulative effect of the amendments did not provide the flexibility needed to implement a cost-effective program.

Senate Bill 819 was ultimately vetoed by the Governor. The veto letter directed DHMH to convene an advisory group composed of affected stakeholders and the Department of Aging and the Department of Disabilities to consult with DHMH to examine fully the impact of applying for a waiver.

Long-term Care Managed Care Waiver Application – 2004 Interim

During the 2004 interim, DHMH has developed a waiver application for submission to CMS to implement a long-term care managed care program. The new CommunityChoice program will manage services for older adults and people with disabilities and will be mandatory for adults who are eligible for both Medicaid and Medicare, other Medicaid beneficiaries aged 65 and over, and adult Medicaid recipients who qualify for nursing home level of care. The program will be offered statewide and provide services to about 75,000 Marylanders. Currently, 3,500 older adults and individuals with disabilities are enrolled in the Waiver for Older Adults and the Living at Home Waiver, which allows waiver enrollees to receive health care in their communities. CommunityChoice will include these waiver populations.

CCOs will provide services to CommunityChoice enrollees and receive a capitated payment for each enrollee. CCOs must include benefits equal to those required under Medicaid, including all primary and acute care, pharmacy, mental health, and long-term care services. For enrollees requiring a nursing facility level of care, a CCO must provide certain augmented community services. DHMH is seeking to create a consumer-centered program in which participants have a choice of CCOs and have the ability to choose and change their primary care provider. The CommunityChoice program will provide for a care coordinator for individuals with more complex health care needs and allow consumers to hire family members, friends, and neighbors as personal care attendants.

Stakeholder Issues

In developing the waiver, DHMH has worked with other State agencies and held stakeholder forums. In September 2004, DHMH sent the waiver application to stakeholders and held stakeholder forums to gather comments on the application. In addition, DHMH scheduled five regional public hearings in late October. A waiver advisory committee to be comprised of 35 legislators and stakeholders is being organized to discuss more specific details in implementing CommunityChoice and to assist in the development of regulations.

Despite stakeholder involvement, providers and advocates continue to have concerns regarding the waiver application, including:

- ***Consumer Protections:*** Providers and advocates are concerned there will not be enough consumer protection in the CommunityChoice program related to network adequacy, access to care, quality standards, and complaints and appeals. The waiver application requires CCOs to maintain an adequate network of primary care, specialist, pharmacy, mental health, nursing facility, personal care, and home and community-based providers, and requires DHMH to monitor and evaluate CCO networks to ensure network adequacy. Of particular concern to advocates is a provision in the waiver application that authorizes DHMH to approve a CCO's network even if the CCO is unable to meet established provider network adequacy standards, if approval of the network will improve enrollees' overall access to quality health care services.

The waiver application also includes access standards related to geographic distance, timeframes for appointments, out-of-network providers, and emergency services.

As for quality standards, DHMH will define measures and standards for CCO performance and will require each CCO to have a DHMH-approved quality assurance program; require an independent external quality review organization to assess CCO performance on quality and access; and establish a consumer advisory board. For complaint and appeals issues, CommunityChoice will provide for an enrollee hotline, internal complaint resolution unit, and Ombudsman Program.

- ***Experiences with Long-term Care Managed Care in Other States:*** Seven states have implemented Medicaid long-term care managed care programs although none are identical to the Maryland proposal in terms of scope and the population to be served. Of the seven programs, Arizona is the only statewide program with mandatory enrollment. Advocates argue that Maryland should follow the example of other states that have implemented their programs on a pilot basis.

  In addition, advocates contend that most states with long-term care managed care programs do not have fully developed provider networks with experience in providing services to individuals with physical and mental disabilities and complex health conditions. Arizona's program was recently subjected to a lawsuit by Arizona Medicaid recipients for having insufficient provider networks, and a federal court ruled that Arizona must provide recipients with promised home and community-based services. DHMH contends that research of other states' capitated programs suggests that CommunityChoice has great potential to improve access to home and community-based long-term care services, better coordinate services, and reduce the rate of growth in Medicaid expenditures.

- ***More Accurate Cost Projections:*** Advocates and providers have raised concerns that DHMH is not providing cost projections to verify that CommunityChoice would achieve savings. CCOs operating long-term care managed care programs in other states have argued that cost savings are achieved. However, DHMH indicates that they are unable to identify specific cost savings to be achieved by CommunityChoice as the particular details of the program are in the development stages.

  Some preliminary savings projections assume the program would achieve about a 1 percent savings the first year, 2 percent the second year, and 3 percent in subsequent years. These projections are based on DHMH's experience transitioning Medicaid recipients from fee-for-service care to managed care under the HealthChoice program. Other managed care long-term care programs around the nation have achieved significant savings, but since no managed care long-term care program is quite like the proposed CommunityChoice program, it is difficult to base savings estimates from existing programs. In general, states with more stringent cost-containment designs, such as mandatory enrollment or rigid gatekeeper functions, save more. DHMH, providers, and consumer groups will have to balance plan design and cost controls in order to deliver the highest quality care in the most cost-effective manner.

- ***Carve-out of Specialty Mental Health Services:*** Mental health advocates are concerned about the inclusion of specialty mental health services in the CommunityChoice program. Such services are currently carved out of Medicaid, and Senate Bill 819 also provided for a mental health carve-out. In particular, advocates argue that DHMH has offered no compelling case to indicate that improved services will be offered by CommunityChoice, that there is no capitated model that adequately serves individuals with serious and persistent mental illness, and that a disruption in the provider-patient relationship would be damaging to this population.

- ***Insufficient Provider Rates:*** Several provider groups are concerned that the rates provided under CommunityChoice will not be sufficient to cover the cost of caring for enrollees. The waiver application authorizes nursing homes to negotiate rates with CCOs and guarantees that the nursing home will receive at least the Medicaid rate. Such assurances are not provided for other providers such as assisted living or adult day care.

Next Steps

DHMH plans to submit the waiver to CMS to implement CommunityChoice prior to the 2005 session. During the upcoming session, possible legislative action may include an override attempt of Senate Bill 819. Additional bills addressing the concerns of interested stakeholders regarding the implementation of a long-term care Medicaid managed care program may be introduced as well.

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Health and Health Insurance

Access to Health Care

The number of people in Maryland who have no health insurance has grown between 2000 and 2002. This trend has prompted State policymakers to look to expand health care coverage. Numerous options are available.

During the 2004 session, legislators were faced with difficult choices concerning access to health care. On the one hand, the State's structural fiscal deficit and anticipated 8 percent annual growth in Medicaid expenditures have led to over $100 million in cost containment measures in the Medicaid program. On the other hand, the number and percentage of individuals in the State without health care coverage have continued to rise, prompting legislative initiatives to expand Medicaid coverage and develop other programs to fill the gap between public and private insurance programs. This paper examines the growing problem of the uninsured in Maryland and the country and provides options for closing the coverage gap.

National Situation

Rising Number of Uninsured

The percentage of the U.S. population covered by health insurance dropped for the third straight year in 2003, leaving an estimated 15.6 percent of the population, or 45 million people, without health insurance coverage. A decline in employer-based coverage was principally responsible for the overall decline. The uninsured rate was particularly high among individuals who were non-white, between 18-34 years of age, and with less than $50,000 of income. The percentage and number of people covered by government health insurance programs, primarily Medicare and Medicaid, has risen steadily since 1999. **Exhibit 1** displays the changes occurring from 2002 to 2003.

Exhibit 1
Changes in Health Insurance Coverage, 2002-2003

	2002		2003	
	Number (Million)	Percentage (%)	Number (Million)	Percentage (%)
Private and Government Coverage	242.4	84.8	243.3	84.4
Employer-based Coverage	175.3	61.3	174.0	60.4
Uninsured	43.6	15.2	45.0	15.6

Note: Types of insurance are not mutually exclusive, and people may be covered by more than one type during the year. Thus, the number and percent covered by adding employer-based and government coverage exceeds the number shown for private and government coverage.

Source: U.S. Census Bureau

Why Are People Uninsured?

The National Institute for Health Care Management Foundation breaks the uninsured into three groups, each with its own characteristics and, therefore, its own set of solutions.

- About one-third of those without health insurance are eligible for public programs but are not enrolled. Reasons for not enrolling include lack of awareness, difficulty in completing the enrollment process, and the stigma associated with public assistance.

- Almost one-fourth of those without health insurance have low incomes but do not qualify for a public program. Insurance is either not offered at work, not affordable, unavailable due to transition from one job to another, aging out of a parent's insurance policy, or retirement.

- The largest category, almost half of those without health insurance, have moderate to high incomes but do not purchase insurance, either because of the expense or a perception that insurance is not important.

The most commonly cited reason why individuals do not take advantage of or buy coverage, or why employers do not offer coverage, is cost. A Kaiser/HRET Employer Health Benefits Survey found that premiums for employer-sponsored coverage increased 13.9 percent from 2002 to 2003. Premiums increased over six times the overall rate of inflation and over four times the wage increases for nonsupervisory workers in 2003. The average monthly premium was $282 for individual coverage and $756 for family coverage. The Kaiser/HRET study found that, as health care costs continued to rise, 65 percent of large companies (200+ employees) and almost 30 percent of small businesses increased employee cost sharing. The study also showed a slight decrease, from 66 to 65 percent, in the percentage of small employers that offered health insurance.

The Consequences of Uninsurance

Much has been written about the adverse effects of being uninsured. For example:

- people who lack health insurance are more likely to forego needed care, resulting in negative health status and adverse financial consequences;
- as a result of foregoing care, the uninsured receive fewer preventive services, are less likely to receive regular care for chronic diseases, are less likely to fill a prescription, and are more likely to be hospitalized for a condition that could have been avoided with timely access to ambulatory care;
- having health insurance increases timely initiation of prenatal care, promotes access to C-section deliveries for high-risk births, and increases access to neonatal intensive care for high-risk babies; and
- individuals who can least afford to pay for health care services are often charged more for services than insured patients who benefit from discounts negotiated by their insurer.

Situation in Maryland

Medicaid and Maryland Children's Health Program Income Thresholds in Maryland

The Maryland Medical Assistance Program covers children and pregnant women with incomes up to 185 percent of federal poverty guidelines (FPG) ($34,873 for a family of four in 2004). Federal poverty guidelines are indexed to inflation. The Maryland Children's Health Program extends coverage to pregnant women with incomes up to 250 percent of FPG ($47,125 for a family of four) and children with family incomes to 300 percent of FPG ($56,550 for a family of four). A premium of about 2 percent of family income is required of child participants with family incomes above 200 percent of FPG ($37,700 for a family of four).

Compared with other states, Maryland has one of the highest eligibility levels for coverage of children. Only two states have higher eligibility levels (New Jersey, 350 percent and Massachusetts, 400 percent), and only four other states similarly extend coverage to 300 percent of FPG. Nearly half of all states and the District of Columbia (25) cover children to 200 percent of FPG, with 11 states covering children with incomes below 185 percent of FPG. Maryland covers pregnant women up to 250 percent of FPG. Only three states (California, 300 percent;

Minnesota, 275 percent; and Rhode Island, 200 percent) cover pregnant women above 250 percent of FPG. Most states (34) do not cover pregnant women beyond 185 percent of FPG.

To qualify for Medicaid as an adult in Maryland, a nonworking parent must have an income of approximately 34 percent of FPG ($6,409 for a family of four), while a working parent must have an income of less than 41 percent of FPG ($7,729 for a family of four). This is well below the national median income eligibility threshold of 43 percent of FPG ($8,105 for a family of four) for nonworking parents and 71 percent of FPG ($13,384 for a family of four) for working parents.

The Uninsured in Maryland

According to a January 2004 report from the Department of Health and Mental Hygiene and the Maryland Health Care Commission to the General Assembly, *Options for Covering the Uninsured*, approximately 690,000 (nonelderly) people in Maryland have neither public nor private health insurance. The rate rose from 12.8 to 14.4 percent from 2000 to 2002. Although the percentage of uninsured children remained constant at 10 percent over the period, a reduction in employment-based coverage from 77 to 75 percent of residents led to an increase in uninsured adults, from 14 to 16 percent.

Maryland's nonelderly uninsured population differs from the national average in some key respects.

- The State's uninsured are more affluent, with 38 percent having family incomes above 300 percent of the poverty level compared to 28 percent nationwide.
- Although the vast majority of the nation's uninsured live in families where at least one adult is employed, Maryland's uninsured are even more likely to live in families with one or more adult workers.
- The uninsured rate for Hispanics in the State is above the national average.
- Non-U.S. citizens are 30 percent of the uninsured in Maryland compared to 20 percent nationwide.

Options for Covering the Uninsured

The National Conference of State Legislatures organizes options for covering the uninsured under four headings: improving access to private coverage; expanding government-sponsored health insurance programs; expanding the safety net and supporting local programs; and developing comprehensive strategies to improve access. Key options under each heading include:

- improving access to coverage:
  - → subsidize private health insurance coverage through premium assistance, State-funded reinsurance, or tax credits;
  - → exempt groups or individuals from mandated benefits;
  - → allow group purchasing arrangements;
  - → eliminate barriers to coverage by restricting premium variations, reforming the individual market, mandating continuation of employer-based coverage for a period of time, expand the definition of "dependent" in insurance policies, and allow other groups to join the State employee health benefit plan;
  - → require certain groups to have coverage;
- expanding government-sponsored health insurance:
  - → increase Medicaid or Children's Health Insurance income eligibility levels;
  - → cover certain optional groups;
  - → target expansion of coverage through federal waivers;
  - → establish a State-only insurance program for individuals not eligible for federal coverage;
  - → establish a State-subsidized high-risk pool for individuals who cannot obtain insurance in the private market due to a health condition;
- expanding the safety net and supporting local programs:
  - → provide State support for community health clinics;
  - → create scholarship and loan programs as incentives for health care providers to practice in underserved areas; and
- developing comprehensive strategies to improve access building on existing coverage and delivery systems – through Medicaid expansion, private health insurance reform, and public-private partnerships – to ensure that all citizens have access to affordable health care.

Proposals to Expand Access to Health Care in Maryland

During the 2004 session, four proposals for expansion of coverage received substantial attention, though only one was enacted. Senate Bill 570 (Chapter 287 of 2004) established a limited health benefit plan to be offered in the small group market, beginning July 1, 2005. The plan will only be available to employers whose average annual wage does not exceed 75 percent of the average annual wage in the State and that have not offered insurance in the past 12 months. The other major proposals considered sought to expand coverage through providing resources to community health resource centers, expanding Medicaid coverage, and providing a financial incentive to obtain health insurance coverage.

It is anticipated that some version of the proposals to expand access to health care that were unsuccessful in 2004 will be reintroduced in the 2005 session. Certainly, concerns about access to care and fairness in paying for coverage will keep the uninsured on the front burner of legislative issues. However, a significant barrier to addressing these concerns remains the State's ongoing budget constraints and the fact that existing public health programs continue to consume a greater percentage of the State's budget.

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Social Programs

Foster Care Caseload Trends

The foster care caseload is decreasing due to a decline in entries and an increase in adoptions. Despite favorable caseload trends, a fiscal 2005 deficit of about $39 million is likely due to a decline in federal funding for the program and an increased number of children requiring intensive services.

The State's foster care and subsidized adoption programs provide temporary and permanent homes for children in need of out-of-home placements due to abuse, neglect, or abandonment. Foster care placements – such as family homes, group homes, and institutions – offer temporary, out-of-home care until achievement of a permanency plan. Permanency options include reunification with the family and adoption. Families that accept legal custody of a child with special needs may receive monthly payments under the subsidized adoption program.

Foster Care and Subsidized Adoption Caseloads

Exhibit 1 shows an anticipated increase of 2.5 percent per year in the combined foster care/subsidized adoption caseload from fiscal 2004 to 2006. The combined increase is the result of a projected increase of 11.0 percent per year in the subsidized adoption caseload, moderated by a 5.1 percent per year decline in the larger foster care caseload. In fiscal 2002 the combined caseload was over 60 percent foster care, but by fiscal 2006 subsidized adoptions will make up over half the total caseload for the first time.

Foster care caseloads continue a moderate downward trend. Between fiscal 2003 and 2004, Baltimore City and seven counties experienced declines of 8 percent or more in children in paid out-of-home placements. Of the four jurisdictions with the largest caseloads, three experienced a decline in the number of entries into foster care and one saw an increase. The Department of Legislative Services (DLS) projects continued moderate declines in the foster care caseload.

Legislation passed in 2001 removed the financial disincentive for foster care families to adopt special needs children. As a result, subsidized adoptions increased dramatically in fiscal 2002 and 2003. DLS projects continued growth in the subsidized adoption caseload.

Exhibit 1
Foster Care and Subsidized Adoption Caseload and Expenditures
Fiscal 2003 – 2006

	FY 2003	FY 2004 Adjusted[1]	FY 2005 DLS Estimate	FY 2006 DLS Estimate	Average Annual % Change FY 2004-06
Caseload					
Foster Care	8,010	7,922	7,519	7,136	-5.1%
Adoption	5,899	6,609	7,335	8,142	11.0%
Total	**13,908**	**14,531**	**14,854**	**15,278**	**2.5%**
Expenditures					
Monthly Cost Per Case	$1,415	$1,480	$1,537	$1,577	3.2%
Total Cost ($ in Millions)	**$236.2**	**$258.0**	**$274.0**	**$289.1**	**5.8%**

[1]Fiscal 2004 caseload reflects a 10-month average from August 2003 to May 2004.

Source: Department of Human Resources, Department of Legislative Services

Funding

Total program costs increased from fiscal 2003 to 2004 and are expected to continue to increase through fiscal 2006. The combined cost per case increased 5 percent from 2003 to 2004, but the aggregate change masks changes in different components of the caseload.

Cost per case for foster care is increasing, but the caseload is shrinking. Cost per case for subsidized adoptions is stable, and the caseload is growing. The cost of subsidized adoption caseload is small, however, relative to that of foster care. DLS projects that case-mix trends in foster care will continue; *i.e.*, the proportion of higher cost placements, such as group homes and institutions, will continue to increase. Regular foster care continues to be the largest single type of placement but is declining, both in real numbers and as a proportion of the total caseload.

The foster care and subsidized adoption program will likely face a fiscal 2005 general fund deficit of about $39 million. There are two primary reasons for the projected deficit:

- Federal Title IV-E (Foster Care) fund attainment has declined considerably. In fiscal 2000 Title IV-E funds provided 34 percent of total spending for foster care; in fiscal 2004 they made up only 22 percent. The proportion of IV-E eligible children in the program is stable, but of children in high cost placements, the proportion who are IV-E eligible is declining. Also, the State may not claim federal Title IV-E funds to pay for the care of a IV-E eligible child if the child resides in an uncertified placement. Kinship care givers often do not go through the process of becoming certified foster care homes. The fiscal 2005 budget assumed that Title IV-E funds would provide 29 percent of total expenditures in the program; fiscal 2004 actual attainment was 22 percent. The lower-than-anticipated Title IV-E attainment results in an estimated $20 million general fund deficit.

- It appears that both caseload and spending were underestimated in fiscal 2004 and 2005. The fiscal 2004 adjusted caseload is over 8 percent higher than was anticipated during the 2004 legislative session. The current DLS caseload projection for fiscal 2005 is about 12 percent higher than the caseload on which the allowance was based. About $19 million in general funds is required to fund the higher than budgeted fiscal 2005 caseload.

Social Programs

Juvenile Justice Trends

The fiscal 2005 budget does not fund the residential capacity necessary to house the current juvenile services population. As a result, overcrowding and/or deficiency appropriations are likely.

Background

In recent years, the ability of the Department of Juvenile Services (DJS) to effectively serve the youth in the juvenile justice system has come under scrutiny. DJS has received particularly harsh criticism for care provided in residential settings. This criticism has been based on both internal and external reviews of residential programming. DJS's own audits have criticized not only the performance of contractors but also DJS's oversight of vendor contracts. Likewise, the State Office of Independent Juvenile Justice Monitor and the federal Department of Justice have been highly critical of the agency.

One of the difficulties analyzing the adequacy of residential services in the juvenile justice system has been the flux in physical capacity. This flux is found in both facilities closing, for example, the Victor Cullen Academy over fiscal 2002 and 2003, as well as the opening of three new regional detention facilities in fiscal 2004. Although the Department of Legislative Services (DLS) expressed concerns about the budgeted capacity for residential services versus likely need, during the 2004 session it appeared that some degree of certainty was finally realized. However, since the session, there have been more changes in proposed programming, some of which have yet to be finalized.

Changes in Residential Capacity

As shown in **Exhibit 1**, in material submitted to the budget committees, DJS is proposing a small increase in both secure detention (pre-adjudication)/pending placement and committed (post-adjudication) residential capacity compared to that proposed in the 2004 session. The increase in secure detention/pending placement capacity is due to increasing these beds at the Hickey School. The increase in committed capacity is derived from a reduction of overall committed capacity at the Hickey School that is more than offset by the new capacity created by the reopening of the Victor Cullen Academy and additional capacity at Cheltenham.

Exhibit 1
Department of Juvenile Services
Selected Residential Capacity – Average Daily Population (ADP)

Placement Type	FY 2004 Actual (ADP)	FY 2005 Budgeted Capacity (ADP)	Revised FY 2005 Capacity (ADP)	Gap between FY 2004 Actual and FY 2005 Revised
Secure Detention/ Pending Placement	429	381	393	-36
Committed	1,545	1,442	1,449	-96
Total	**1,974**	**1,823**	**1,842**	**-132**

Source: Department of Legislative Services, Department of Juvenile Services

A number of points emerge from the exhibit:

- Even with the increased capacity, overall capacity in fiscal 2005 is still less than actual utilization in fiscal 2004. Further, there is no reason to believe that populations will see much change. The secure detention/pending placement population has been relatively stable for the past four fiscal years; the committed population has fallen, but only slightly over the same period.

- The projected gap in the secure detention/pending placement capacity is based on the assumption that the three new facilities are operating at maximum capacity and that the population at most existing facilities is lowered to levels more consistent with design and available staffing.

- In particular, this means the 144-bed Baltimore City Juvenile Justice Center (BCJJC) is operating at full capacity. DJS has faced significant criticism for its performance at BCJJC as that population has grown, although the population has never reached capacity (the highest monthly average was 111 in August 2004). This criticism includes the inability to hire and retain appropriate staff. DJS has publicly committed to having the appropriate level of staff to operate BCJJC at 144 beds. Without these beds, overcrowding at other facilities is certain.

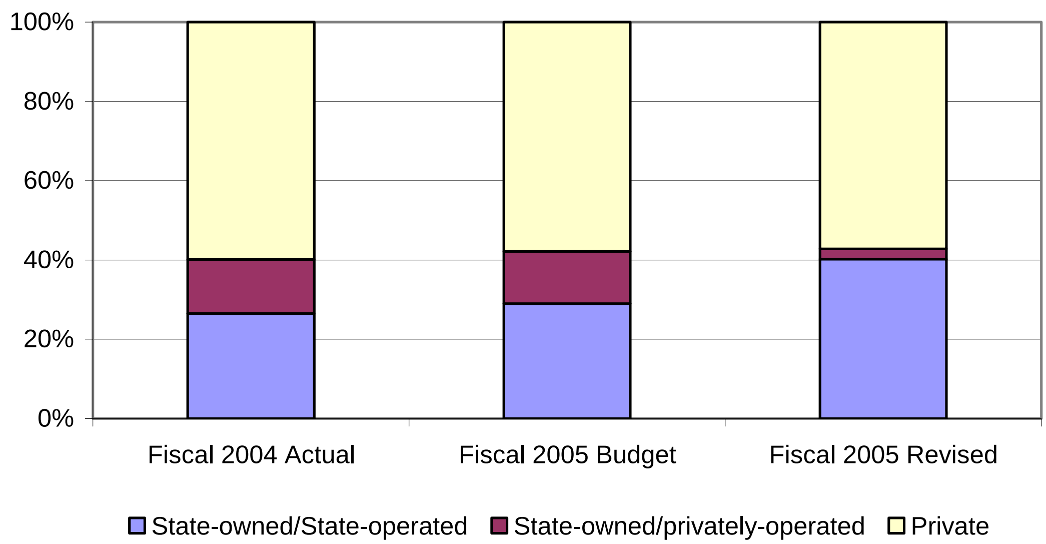
- The gap in committed placements will place further pressure on the DJS per diem (private provider) budget. This budget has been historically underfunded, and DLS predicts the need for a deficiency appropriation of at least $4.4 million to cover prior year deficits rolled into fiscal 2005 as well as fiscal 2005 utilization above that budgeted.

- Adding additional capacity for committed youth at Cheltenham as proposed by DJS appears to move away from the policy direction previously stated by the department of avoiding mixing youth awaiting adjudication/permanent placement with those in a permanent post-adjudication placement. It also shifts the long-stated focus for Cheltenham away from strictly a regional detention facility.

Changes in the Service Delivery Mix

In addition to revising residential capacity, since the 2004 session DJS has markedly changed how services are delivered. As shown in **Exhibit 2**, DJS has virtually eliminated any capacity at State-owned but privately-operated facilities. This is due to the department's decision to operate the Hickey School itself after attempts to find a new vendor failed and because the department plans to operate the additional residential capacity to be created at Cheltenham and Victor Cullen.

Exhibit 2
DJS Residential Services – Service Delivery Mix



Source: Department of Legislative Services, Department of Juvenile Services

This change in service delivery mix raises a number of issues:

- The proposed changes in programming at Hickey School as well as the new programming at Victor Cullen and Cheltenham have yet to be detailed by DJS. Specifically, it is not clear if the $17.2 million available in the budget to operate Hickey School will be sufficient for the proposed programming at all three facilities. If not, the department has not indicated a source for additional funds.

- It is also unclear if DJS can recruit and retain workers for the new programming, especially given the department's recent difficulty hiring workers for BCJJC and because the department has given no indication that it will be looking to create new regular positions until fiscal 2006. While DJS was able to retain most of the staff previously employed at Hickey School under a private contract, retained staff are contractual not regular employees and thus lost benefits. DJS has already indicated some problems attracting staff at Victor Cullen because they are currently offering only contractual positions. DJS has a long and troubled history of over-reliance on contractual employees and has only recently undergone a three-year effort to reduce the extent of contractual employment in the department.

Conclusion

Far from stabilizing, the DJS delivery system for residential services appears more uncertain now than in the 2004 session. The total capacity for secure detention/pending placement and committed residential services remains below the most recent actual levels of demand prompting concerns about overcrowding, the ability to provide adequate staffing, and budget uncertainty. The department has also been forced to take on additional responsibility for the direct delivery of services as well as proposing new committed programming at two additional facilities while to date providing little detail on how they intend to fulfill this responsibility.

Social Programs

Temporary Cash Assistance Caseload and Expenditure Trends

After remaining stable for several years, the Temporary Cash Assistance caseload is declining again, dropping below 70,000 people for the first time. The decline follows the implementation of a "universal engagement" policy.

Background

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or relative caretakers. The program is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections.

Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy led to rapid reductions in the number of TCA recipients. After dropping at rates exceeding 20 percent per year during the late 1990s, the pace of caseload decline has slowed considerably in the early years of this decade. With the recovering economy and the implementation of a universal engagement policy in fall 2003, the caseload declined again in fiscal 2004, dropping below 70,000 for the first time. Universal engagement requires participation in activities such as up-front job search, orientation, assessment of employability, developing an Independence Plan, training, and subsidized employment.

Fiscal 2005 Forecast

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) estimates an annual average caseload of 68,469 for fiscal 2005, a decline of 4.6 percent from the previous year. The projected decline is based on recent caseload experience. While the average caseload in fiscal 2004 was 71,179, the monthly average for the last six months of the year was only 69,491. In addition, in the first two months of fiscal 2005, the caseload dropped below 69,000 for the first time. The projected caseload is lower than was assumed in the fiscal 2004 budget. As a result, DLS is projecting a fiscal 2005 surplus in the program of $2.6 million. Some of the surplus will likely be needed to cover deficits in other assistance programs.

Exhibit 1
TCA Enrollment and Funding Trends
Fiscal 2004 – 2006

	FY 2004 Actual	FY 2005 Appropriation	FY 2005 Estimate	FY 2006 Estimate	Percent Change FY 2005-06
Average Monthly Enrollment	71,179	71,793	68,469	68,469	0.0%
Average Monthly Grant	$146.15	$147.86	$147.33	$148.43	0.8%
Funds in Millions					
General Funds	$23.3	$43.6	$43.6	$33.7	-22.8%
Total Funds	**$123.8**	**$123.7**	**$121.0**	**$122.0**	**0.8%**

Source: Department of Human Resources, Department of Legislative Services

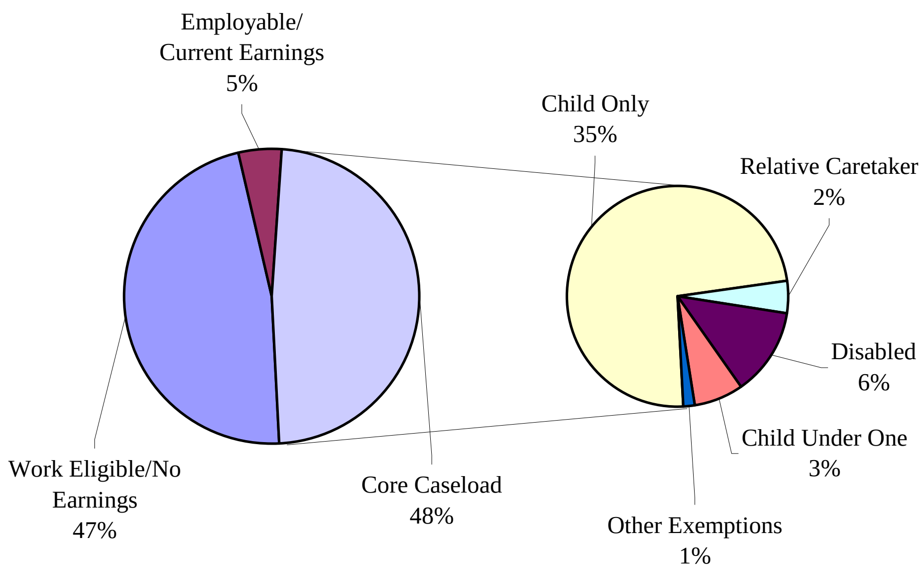
Fiscal 2006

DLS expects the caseload to remain stable in fiscal 2006 because continuing declines due to universal engagement may not be possible. DLS estimates a caseload of 68,469, an average grant amount of $148.43, and total expenditures of $122.0 million. The estimates of average grant and total expenditures reflect the annualized cost of a 1.073 percent increase in the grant amount in fiscal 2005 and assume another 1 percent increase in October 2005. General funds decrease because DLS assumes that $7 million of TANF bonus funds awarded in October 2004 will be available for expenditure in TCA in fiscal 2006.

Characteristics of the Current Caseload

To track recipients needing employment services, the Department of Human Resources (DHR) divides the caseload into two main groups: (1) the “core” caseload and (2) cases headed by an employable adult. The core cases include child only cases, women with children under age one, disabled cases, relative caretakers, and other cases exempted from work requirements. With the exception of women with children under age one, the department does not expect the core cases to transition off cash assistance by seeking employment. Child only cases, for example, typically leave the rolls after reaching adulthood. As employable adults have successfully entered the labor market, the core cases have represented an increasing percentage of the total TCA caseload. As shown in **Exhibit 2**, core cases comprised 48 percent of the TCA caseload in July 2004, slightly greater than the previous year’s rate at 46 percent and higher still from 37 percent in December 1998.

Exhibit 2
Characteristics of TCA Cases



Source: Department of Human Resources

DHR focuses its employment programs on the cases headed by an employable adult. Exhibit 2 shows that these cases represented 52 percent of the total TCA caseload in July 2004. A small percentage of the employable cases currently participate in the labor market, but, because of insufficient earnings, they continue to receive cash assistance. Most of the remaining employable adults are in work-related activities but not receiving any earnings.

In the early years of welfare reform, DHR concentrated on serving those easiest to place in employment. Through its successful efforts, most of these cases have transitioned from welfare to work. Now, the remaining cases headed by an employable adult typically face multiple barriers to employment such as substance abuse and/or mental health issues, poor work histories, low educational attainment, and limited access to transportation and child care. To realize further caseload reductions, DHR must continue to provide intensive services to help these employable adults enter and remain in the labor force.

Five-year Lifetime Limit on Receipt of Cash Assistance

Moving employable adults to jobs is particularly important in light of the federal lifetime limit placed on receipt of cash assistance. Federal law prohibits cases headed by an adult from receiving TANF-funded cash benefits for more than five cumulative years. However, federal law also provides exemptions to the time limit for "hardship," as defined by the state. Under this provision, 20 percent of the adult-headed caseload receiving TANF-funded cash assistance from the previous federal fiscal year may continue to receive these benefits beyond five years.

July 2004 was the thirty-first month under welfare reform that families reached the five-year benefit limit in Maryland. Of the 26,012 cases in that month, 1,530 had been receiving TCA benefits for 60 months or longer. Since this number was below the 20 percent exemption limit of 5,202, no one was removed from the caseload. According to DHR's projections, the earliest that any recipient would lose benefits because of the time limit is fiscal 2014. Until that time, the department expects to accommodate, under the federal hardship exemption, all families who cooperate with program requirements.

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Social Programs

Child Welfare Staffing Levels

Despite legislative directives, staffing levels for the State's child welfare programs (adoption, foster care, protective services, etc.) remain well below the level recommended by the Child Welfare League of America.

Background

Staffing for local child welfare services is a chronic problem. In 1998 the General Assembly passed the Child Welfare Workforce Initiative, which required the Department of Human Resources (DHR) and the Department of Budget and Management (DBM) to develop appropriate caseload to staff ratios using standards recommended by the Child Welfare League of America (CWLA). The State has never attained the staffing necessary to meet CWLA standards due to cost containment measures begun in the fall of 2001.

In May 2003, DBM provided DHR with a blanket exemption from the hiring freeze for child welfare positions. DHR was slow to take advantage of this exemption. Notice was not given to the local departments of social services about the hiring freeze exemption until correspondence was sent on October 22, 2003, indicating that the department would "… generally support after a thorough review on a case-by-case basis filling [certain child welfare positions]." The department limited this review to only those positions vacated after October 1, 2003.

To encourage the department to increase its efforts to fill and retain caseworker positions, the General Assembly added language to the fiscal 2005 budget restricting expenditure of general funds unless filled position targets were met by certain dates as shown in **Exhibit 1**. While these targets are below the levels required to meet the CWLA recommendations, meeting the targets would be a significant improvement over current caseload to worker ratios.

Exhibit 1
Filled Position Targets and Funding Restrictions

By	Filled Caseworker and Supervisor Positions Needed	General Funds Restricted if Target Not Met
October 1, 2004	1,880	$1,500,000
January 1, 2005	1,891	1,000,000
March 1, 2005	1,891	1,000,000

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

Discussion

DHR did not meet the October 1, 2004, target. Filled caseworker and supervisor positions on October 1, 2004, totaled 1,770 as shown in **Exhibit 2**. Filled positions actually *decreased* between March and July 2004 before increasing to the October level. This demonstrates the need to not only increase efforts in hiring new employees but also to improve retention as well.

To increase the number of new hires, the department has taken several steps. These steps include the development and web posting of a full page advertisement for child welfare positions in the Maryland area and instituting a "quick hire" process in which applications are accepted continuously and the eligibility lists are updated twice monthly. The web announcement is on the DHR web site as well as being linked to a number of national social services association web sites.

On the retention side of the equation, the department has indicated that reducing the caseload levels will yield the biggest results in retaining employees. Additional retention measures, such as better training, could also help slow the rate of employees leaving these positions. According to the department, the increased salaries that resulted from passage of House Bill 1133, the Child Welfare Workforce Initiative of 1998, have helped in both recruitment and retention. A cursory search of child welfare positions advertised in Washington, DC indicated that for positions requiring a year of experience, the starting salaries in Washington, DC were $3,000 to $4,000 higher than similar positions in Maryland.

Exhibit 2
Child Welfare Staffing Levels

		March 2004	July 2004	October 2004	CWLA Guideline	Budget Bill Language
Caseworkers	Filled	1,403	1,417	1,461	1,642	1,567
	Vacant	198	201	172		
Supervisors	Filled	321	301	309	330	313
	Vacant	10	28	21		
Total	**Filled**	**1,723**	**1,718**	**1,770**	**1,972**	**1,880**
	Vacant	**206**	**229**	**193**		

Note: Numbers may not sum due to rounding.

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

Social Programs

Faith-based Initiatives

The General Assembly added language to the fiscal 2004 and 2005 budgets prohibiting the establishment of a faith-based office unless the office was authorized by the General Assembly. In October 2004 the Governor created the Office of Community Initiatives through an executive order. The charge of the office does not appear inconsistent with the budget language.

Federal Faith-based Initiatives

Almost immediately after being sworn into office in 2001, President George W. Bush established a White House Office of Faith-based and Community Initiatives. In addition to establishing the White House Office, the President, through a series of executive orders established adjunct faith-based offices in various federal departments. The White House Office oversees and coordinates the activities of these “centers.” The centers’ responsibilities include coordinating department-wide efforts to “incorporate faith-based and community organizations in department programs and initiatives.”

Another executive order laid the framework for faith-based and community organizations to access federal grants. The order specified that federal assistance could include grants, contracts, loans or loan guarantees, property, cooperative agreements, food, or direct appropriations. Tax credits, deductions, or exemptions, however, were not included. The order stated that any organization receiving federal funds cannot discriminate on the basis of religion or religious belief. In addition, the order provided that faith-based organizations cannot proselytize using federal assistance, but faith-based organizations may compete for federal assistance without affecting their ability to conduct overtly sectarian activities.

The White House Office also established a web page providing a “how to process” that faith-based and community organizations may use to access federal grants. The web page lists grants that may be of interest to faith-based and community organizations and also provides Internet links to the various federal agencies that administer the relevant grant programs. Two types of federal grant programs may provide funding for faith-based organizations. Block grants are made generally to states or localities based on a formula. Discretionary grants are awarded on a competitive basis by a federal agency. In federal fiscal 2003, $14.5 billion was available for discretionary federal grants in the five largest agencies where Centers for Faith-based and Community Organizations were established. Of that $14.5 billion, faith-based and community organizations received $1.17 billion nationwide.

Maryland Faith-based Initiative

Maryland has a long history of involvement with faith-based organizations. Over the years Maryland has provided State funds to religiously affiliated hospitals, nursing homes, private schools, and private institutions of higher education. These funds primarily are for service-related activities such as patient care. Recently, although not without some controversy, the State has also earmarked specific funds for textbooks in private schools, some of which may also have religious affiliations. In addition, the State's capital program may directly fund religious organizations. These funds, however, are given with strict requirements for the use of the funds, and the legislation that authorizes the disbursement of State funds prohibits their use in order to proselytize.

Maryland also complies with the 1996 landmark federal welfare reform law's charitable choice provision. Charitable choice precludes states from excluding faith-based organizations from participating in government contracts because they are sectarian. Therefore, Maryland has contracted with faith-based organizations to serve Marylanders on welfare.

With the election of a new Maryland Governor in 2002, it was anticipated that the Governor would submit legislation establishing an office similar to the White House Office of Faith-based and Community Initiatives. A bill establishing an office was not part of the Governor's legislative package during the 2003 or 2004 legislative sessions. Instead, legislation was introduced and passed by the House of Delegates in 2003 that would have established a Community and Faith-based Partnership Council. The legislation ultimately failed, but for the past two sessions language was included in the budget bill that prohibited the establishment of a faith-based or similar type office, unless the office was authorized by the General Assembly. The budget language has been opposed by the Administration as a potential impediment to the receipt of federal funding. A Department of Legislative Services (DLS) review of federal grants found no indication that any federal funds are contingent upon a State having a faith-based office or liaison.

Despite the prohibition against establishing an office, the Administration has taken steps to increase outreach to faith-based and community organizations. These steps are somewhat inline with priorities expressed by the White House Office. A person in the Lieutenant Governor's office was initially designated as the State liaison with the federal government to coordinate State activities regarding faith-based and community initiatives. As with a state office, there are no indications that designating a liaison is mandatory or contingent upon anything. The Department of Human Resources (DHR) web site provides information regarding federal grants available for faith-based organizations. In addition, a staff person in DHR's Community Services Administration provides technical support for faith-based organizations wishing to access federal discretionary grants.

In October 2004, the Governor established the Office of Community Initiatives through an executive order. In addition to its delineated responsibilities, the office will coordinate the activities of the Governor's Office on Service and Volunteerism and the Volunteer Maryland Program. As specified in the executive order, some of the office's 14 responsibilities include:

- coordinating community and volunteer service activities within the State;
- advising the Governor on policies and measures to enhance and improve the delivery of community programs and initiatives;
- serving as the principal liaison to the White House Office of Faith-based and Community Initiatives;
- reviewing State and federal legislation to ensure that community organizations are afforded the fullest opportunity permitted by law to "equally" participate in the competitive process for federal, State, and private funding; and
- coordinating State programs providing health, social, educational, or other community services within the restrictions created by the Maryland General Assembly through language in the fiscal 2005 budget, which maintains the eligibility of faith-based organizations to receive monies under any program funded in the 2005 budget.

The executive order specifies that the office will primarily be coordinating, monitoring, and reviewing. Many of the office's responsibilities are similar to the responsibilities of the White House Office. The office's establishment does raise questions regarding compliance with the fiscal 2005 budget language. The budget language provides that "no funds in this budget may be expended pursuant to, or in furtherance of, any policy, program, or office, so named or otherwise, to purposefully promote or facilitate participation of faith-based organizations in State programs… ."

Except for acting as a liaison to the White House Office, the executive order does not directly address "faith-based organizations" in Maryland. Nevertheless, President Bush's initiative directly links faith-based and community organizations so it can be assumed that the State office will also include faith-based organizations in its activities. The executive order's wording appears benign enough so that it does not contradict the budget language, and it does mention that the office will work within the restrictions of the budget language. By staying focused on all types of community organizations, the office should operate within its bounds. If the office increases its focus on faith-based organizations or develops programs that directly benefit faith-based organizations similar to the federal Capital Compassion Fund, the office may violate the budget language.

A person familiar with the President's Faith-based and Community Initiative indicated that the value of a state office is at the "grass roots" level. A state faith-based and community initiative office could mobilize local groups to obtain discretionary grants and could eliminate or navigate around obstructions for these groups. If more information is desired, DLS has available a more comprehensive analysis of faith-based initiatives.

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Transportation

Major Changes in the Consolidated Transportation Program

The Maryland Department of Transportation's draft 2005 *Consolidated Transportation Program* lists all capital projects funded in the current fiscal year as well as those planned for the next five years. Projected State funding in the 2005 draft six-year program increases by 21.7 percent; federal aid is projected to increase by 11.6 percent.

Overview

The Maryland Department of Transportation (MDOT) publishes an annual *Consolidated Transportation Program* (CTP) that lists all capital project funds in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's proposed six-year program with the six-year program contained in the draft 2005 CTP currently under development.

Exhibit 1
Comparison of Proposed Capital Program
($ in Millions)

	2004-09 CTP	2005-10 Draft CTP	Change	Percent Change
State Funds				
Special Funds	$3,427.1	$4,695.1	$1,268.0	37.0%
Other Funds*	1,056.5	759.9	-296.6	-28.1%
Subtotal State Funds	4,483.6	5,455.0	971.4	21.7%
Federal Aid	3,167.5	3,535.1	367.6	11.6%
Total Funds	**$7,651.1**	**$8,990.1**	**$1,339.0**	**17.5%**

* Other funds includes proceeds from the sale of bonds issued by the Maryland Transportation Authority and the Maryland Economic Development Corporation, customer facility charges collected by the Maryland Aviation Administration, and certain types of federal aid that do not pass through the Transportation Trust Fund.

Source: Maryland Department of Transportation, 2005 Draft *Consolidated Transportation Program*

The funding level projected in the 2005 six-year program increases by $1.34 billion (17.5 percent) over the six-year capital program funding level in the 2004 CTP. An increase of 37 percent in special funds is primarily due to the enactment of Chapter 9, Acts of 2004, a transportation revenue package. The decrease of 28.1 percent in other funds is primarily due to the completion of major construction projects at the Baltimore/Washington International (BWI)

Airport and the Largo extension of the Washington Metropolitan Area Transit Authority Metro system.

Changes in Federal Aid

Federal aid to Maryland's capital program is estimated to increase by $367.6 million (11.6 percent). The authorization act for federal spending on highway and transit construction in the United States, the Transportation Equity Act for the 21st Century, was scheduled to expire September 30, 2003. However, this existing authorization was extended six times during calendar 2004. The most recent extension was enacted on September 30, 2004, and can remain in force for up to eight months. The level of funding that Maryland can expect to receive under the new reauthorization act remains very uncertain.

Summary of Major Changes

As shown in **Exhibit 2**, projects totaling $283.8 million were added to the construction program, $762.5 million in projects were moved from the development and evaluation (D&E) program to the construction program, and $30.2 million in projects were added to the D&E program. The large number of projects added and moved in the CTP is due to the enactment of the transportation revenue package. Exhibit 2 also shows a number of projects that have experienced construction schedule delays. Many of the construction schedule delays are Maryland Aviation Administration (MAA) projects dealing with Federal Aviation Administration (FAA) coordination, environmental analysis, and land acquisition program setbacks.

Exhibit 2
Major Changes in the 2005
Consolidated Transportation Program
($ in Millions)

Projects Added to the Construction Program

	Project Description	**Cost**
MAA	Hagerstown Airport Expansion	$57.6
MTA	MARC Mid-Life Overhaul of GP40 and AEM 7 Locomotives	71.4
MTA	MARC II Vehicle Mid-Life Overhaul	25.3
SHA	MD 331, Dover Road; replace bridge over Choptank River (Talbot)	48.4
SHA	MD 295, Baltimore Washington Parkway; MD 295 from I-695 to I-195 (Anne Arundel)	23.7
SHA	MD 45, York Road; MD 45 from Cavan Road to Ridgeley Road (Baltimore)	12.6

Exhibit 2 (continued)

	Project Description	Cost
SHA	MD 90, Ocean City Expressway; MD 90 bridges over Assawoman Bay and St. Martins River (Worcester)	11.4
SHA	I-83, Harrisburg Expressway; replace bridges over NCR Trail and Little Falls (Baltimore)	11.2
SHA	MD 40, Pulaski Highway; US 40 from MD 152 to MD 24 overpass (Harford)	8.2
SHA	MD 47, Barrelville Road; replace bridge over North Branch (Allegany)	3.4
SHA	MD 194, Francis Scott Key Highway; replace bridge over Big Pipe Creek (Carroll)	3.2
SHA	MD 450, Annapolis Road; replace bridge over CSX (Prince George's)	3.2
SHA	MD 260, Chesapeake Beach Road; replace bridge over MD 260 (Calvert)	1.7
SHA	MD 7B, Philadelphia Road; replace bridge over Mill Creek (Cecil)	1.5
SHA	MD 874C, Old New London Road; replace bridge over Ben's Branch (Frederick)	1.0
	Total	**$283.8**

Projects Moved from the D&E Program to the Construction Program

	Project Description	Cost
MTA	Baltimore Corridor Transit Study – Red Line	$229.0
SHA	MD 4, Pennsylvania Avenue; interchange at Suitland Parkway (Prince George's)	70.7
SHA	I-70, Baltimore National Pike; I-70 Phase 2B, 2C, Walser Drive, MD 355, and MD 475 South Street to Monocacy Boulevard (Frederick)	65.6
SHA	MD 30 relocated, Hampstead Bypass; MD 30 relocated from south of Hampstead to north of Hampstead (Carroll)	63.4
SHA	I-95/I-495, Capital Beltway; interchange improvements at Branch Avenue Metro Station (Phase I) (Prince George's)	49.6
SHA	MD 237, Chancellors Run Road; MD 237 from Pegg Road to MD 235 (St. Mary's)	42.2
SHA	MD 355, Rockville Pike; MD 355 from Old Georgetown Road to Maple/Chapman Road (Phase I) (Montgomery)	40.3
SHA	US 219 relocated Oakland; Oakland Bypass (Garrett)	35.5
SHA	MD 5 relocated at Hughesville; Hughesville Bypass (Charles)	34.1
SHA	MD 124, Woodfield Road; MD 124 from Airpark to Fieldcrest (Montgomery)	33.2
SHA	MD 32, Patuxent Freeway; MD 32 at Burntwoods Road (Howard)	25.4
SHA	MD 2/4, Solomons Island Road; MD 2/4 intersection at MD 231 (Calvert)	16.8
SHA	I-95/I-495, Capital Beltway; interchange improvements at Arena Drive (interim improvements) (Prince George's)	16.6

Exhibit 2 (continued)

	Project Description	Cost
SHA	MD 404, Shore Highway; study to upgrade MD 404 from Double Hills Road to MD 16 (Caroline)	14.6
SHA	I-695, Baltimore Beltway; interchange reconstruction at US 40 (Baltimore)	7.7
SHA	US 15, Catoctin Mountain Highway; study to reconstruct the existing interchange at MD 26 (Frederick)	1.5
	Total	**$762.5**

Projects Added to the D&E Program

	Project Description	Cost
MTA	I-270 Corridor Cities Transitway	$11.0
MTA	Baltimore Corridor Transit Study – Green Line	10.0
SHA	US 50, Ocean Gateway; US 50 bridge over Sinepuxent Bay	2.5
SHA	MD 295, Baltimore Washington Parkway; MD 295 from MD 100 to I-195 (Anne Arundel)	2.2
SHA	US 29, Columbia Pike; US 29 from Middle Patuxent River to Broken Land Parkway (Howard)	1.7
SHA	US 301, Blue Star Memorial Highway; US 301 at MD 404 (Queen Anne’s)	1.5
SHA	US 1, Washington Boulevard; US 1 Corridor Study (Howard)	1.3
	Total	**$30.2**

Construction Schedule Delays

	Project Description	Comment	Fiscal Year
MVA	Electronic Lien, Title and Registration System (TARIS 2)	Delay due to rephasing of electronic lien portion	2006 to 2007
MVA	National Motor Vehicle Title Information	Delay due to schedule of American Association of Motor Vehicle Administrators	2005 to 2007
MAA	Noise Zone Land Acquisition Program	Part 150 Noise Contour Map update required before land acquisitions resume	2005 to 2006
MAA	Homeowner Assistance Program	Noise Contour Map update required before receiving federal funds	2005 to 2006
MAA	Protective Land Acquisition Program	Land acquisitions to resume in fiscal 2005	2004 to 2005
MAA	Runway Reconstruction at Martin State Airport	Delay due to coordination of environmental and planning components with FAA	2005 to 2008

Exhibit 2 (continued)

	Project Description	Comment	Fiscal Year
MAA	Midfield Complex – New Air Traffic Control Tower for Martin State Airport	Construction delay due to further coordination with FAA	2005 to 2007
MAA	People Mover System at BWI Airport	Design delay to address scope rephasing	2004 to 2005
MAA	Midfield Complex – Aircraft Hangars at Martin State Airport	Design delay to coordinate with environmental analysis	2004 to 2005
SHA	MD 732, Guilford Road; Replace Bridge 13029 over CSX Railroad (Anne Arundel, Howard)	Delay in acquisition of needed right-of-way	2004 to 2005

MTA – Maryland Transit Administration
MVA – Motor Vehicle Administration
SHA – State Highway Administration

Source: Maryland Department of Transportation, 2005 Draft *Consolidated Transportation Program*

Transportation

Legislative Oversight of the Maryland Transportation Authority

During the 2004 legislative session, the General Assembly sought to increase its oversight of the Maryland Transportation Authority (MdTA) by adopting provisions that changed MdTA's authority to issue bonds. While the oversight principles embodied in these provisions are warranted, the provisions may be more restrictive than intended. The General Assembly will, therefore, likely revisit the issue during the 2005 session.

Background: Expanding Role of the Maryland Transportation Authority in Transportation Financing

Established in 1971 as an independent, nonbudgeted State agency, the Maryland Transportation Authority (MdTA) is responsible for the operation of the State's seven existing toll facilities. MdTA has assumed an expanded role in financing non-tolled transportation facilities since the 1980s. MdTA has provided fund transfers and loans to the Maryland Department of Transportation's (MDOT) Transportation Trust Fund (TTF) and has assumed responsibility for building non-tolled facilities that could not be financed through the TTF. MdTA has also served as the conduit through which debt backed by a variety of revenue sources has been issued by several MDOT modal administrations.

In 2004, control over the construction of the proposed InterCounty Connector (ICC) highway was transferred from MDOT to MdTA. In addition to overseeing the project's design and implementation, MdTA is expected to provide the majority of the financing for the project through the issuance of (1) revenue bonds backed by tolls on its existing facilities as well as tolls that would be collected on the ICC and (2) a form of debt called a Grant Anticipation Vehicle, which is a bond backed by a state's federal highway aid receipts.

Existing Legislative Oversight of MdTA

At the present time, the General Assembly has very limited oversight of MdTA. Under current statute, the General Assembly:

- reviews MdTA's operating and capital spending plans but does not appropriate MdTA's budget. The General Assembly has no authority to reduce a budget or restrict MdTA's expenditures.

- receives notice when MdTA enters a contract for a new revenue-producing facility and may review and comment upon such notices but may not approve or disapprove of the contract.

- has no authority over MdTA's issuance of any type of debt.

Expanding Legislative Oversight of MdTA

During the 2004 session, the General Assembly expanded its oversight of MdTA by adopting provisions that prohibit MdTA from issuing bonds to finance a transportation facility until the General Assembly has approved the specific project and the maximum amount of bonds to finance the project. These provisions take effect on July 1, 2005. While the oversight principles embodied in the provisions are warranted, the provisions may be more restrictive than intended. The provisions will require MdTA to obtain the approval of the General Assembly to issue bonds to finance not only new revenue-producing projects but also regular maintenance. In addition, the provisions will require MdTA to present an annual bond bill to the General Assembly for approval during the regular session. Finally, the provisions make no distinction between bonds issued by MdTA to fund its own projects and bonds issued by MdTA on behalf of other parties.

Alterations of Current Provisions

Given concerns with the provisions passed during the 2004 session, it is likely that MdTA oversight will be revisited during the 2005 session. Among the possible options are the following:

- repeal the provisions enacted in 2004 and impose no new limits.

- repeal the provisions enacted in 2004 and impose a limit on the total amount of debt that MdTA may have outstanding at any one time. The imposition of such a debt ceiling would mirror the debt ceiling currently imposed on MDOT's issuance of consolidated transportation bonds and would impose no limitations on the purposes for which MdTA could issue debt.

- repeal the provisions enacted in 2004 and pass a law requiring approval of the construction of new revenue-producing transportation facilities projects. The passage of such a provision would give the General Assembly control over new projects undertaken by MdTA.

- bring MdTA on-budget, thereby requiring the Governor to provide an annual allowance and the General Assembly to approve an annual appropriation. By bringing MdTA on-budget, the General Assembly would greatly expand its oversight of all aspects of MdTA's operations and capital projects.

Transportation

Commercial Driver's Licenses

Federal regulations governing commercial driver's licenses (CDLs) were recently adopted to expand the list of motor vehicle violations for which CDL holders are subject to disqualification penalties. The regulations also modify the treatment of a verdict of probation before judgment for a CDL offense subject to disqualification. All states, including Maryland, must implement these changes or face the loss of federal funds.

Background

On July 31, 2002, and January 29, 2003, the Federal Motor Carrier Safety Administration (FMCSA) published separate final rules to implement the Motor Carrier Safety Improvement Act of 1999. These final rules ensured uniformity among commercial driver's license (CDL) systems in all states. Under the federal rules, all states must implement these changes to CDL licensing and penalty requirements or face the loss of federal highway funds and federal grants from the Motor Carrier Safety Assistance Program (MCSAP). According to the Maryland Department of Transportation, Maryland stands to lose 5 percent of the State's allocation of federal highway funds for the first year in which the State is not in compliance with this federal law; based on data from fiscal 2004, this loss is estimated at approximately $16.5 million. The percentage of lost highway funds rises to 10 percent in the second and subsequent years of noncompliance, which is estimated at approximately $33 million annually. In addition, the State stands to lose approximately $2.4 million annually in MCSAP grant funding.

Disqualifying Offenses for CDLs in Maryland

Currently, the disqualification penalties that the Motor Vehicle Administration (MVA) may impose on a CDL holder range from disqualification for 60 days to a lifetime disqualification, depending on the offense. These penalties only apply to offenses that occur while driving a commercial vehicle. The offenses that subject a CDL holder to a one-year disqualification include driving under the influence of alcohol or a controlled substance, refusing to take an alcohol test, leaving the scene of an accident, or using a commercial vehicle to commit almost any felony. A CDL holder who carries hazardous materials is subject to a three-year disqualification. Subsequent offenses subject the CDL holder to a lifetime disqualification. A lifetime disqualification penalty is also imposed on a first offense of using a commercial vehicle while committing a felony involving the manufacture, distribution, or dispensation of a controlled dangerous substance. Convictions for various combinations of less severe offenses over various periods of time subject the CDL holder to 60- or 120-day disqualifications.

Anticipated 2005 Legislation

Legislation (Senate Bill 396/House Bill 163) was introduced during the 2004 session to bring Maryland into compliance with federal requirements. Senate Bill 396 passed the Senate but not the House. The 2005 legislation is likely to include all of the provisions of the 2004 legislation, as well as changes required by a compliance review conducted by FMCSA. In response to concerns expressed by the General Assembly, the 2005 legislation is likely to limit the application of the proposed disqualification provisions to offenses that occur after the effective date of the bill.

To comply with the final regulations and avoid the loss of federal funds, State laws will need to be amended in the 2005 session to provide that:

- disqualifying offenses include specified serious offenses that occur in a non-commercial vehicle;

- driving a commercial vehicle with a revoked, suspended, cancelled, or disqualified CDL as a result of violations committed in a commercial vehicle or causing a fatality through the negligent operation of a commercial vehicle will result in a one-year disqualification for the first conviction and a lifetime disqualification for a subsequent conviction;

- driving a commercial vehicle without obtaining a CDL, driving a commercial vehicle without possessing a CDL, or driving a commercial vehicle of an improper class or with an improper endorsement will result in a 60- or 120-day disqualification;

- a verdict of probation before judgment for these CDL offenses will be considered a conviction for CDL disqualification purposes;

- a driver will be disqualified if the U.S. Department of Transportation imposes an emergency disqualification or if the driver operates a commercial motor vehicle while subject to an out-of-service order;

- the MVA must suspend, revoke, or cancel a driver's CDL application or disqualify the driver for at least 60 days if it discovers that the driver submitted fraudulent CDL application information; and

- Canadian and Mexican CDL holders may operate a commercial vehicle in Maryland, and National Guard military technicians are exempt from Maryland CDL requirements.

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Transportation

Driver's Licenses for Undocumented Immigrants

Access of undocumented immigrants to driver's licenses has become a national issue since the 2001 terrorist attacks. States across the nation have been reexamining their processes for issuing driver's licenses and taking steps to reduce fraudulent use. In Maryland, legislation adopted in 2003 created a task force to further explore driver licensing documentation; the task force's recommendations could result in legislation.

Background

The documentation used to obtain driver's licenses has become a controversial issue since the terrorist attacks of September 11, 2001. Before the terrorist attacks, at least 15 states were considering easing immigrant driver's license restrictions. Immigrant advocacy groups had long argued that denial of licenses to immigrants compromised public safety on the highways. Because driving is a necessity to obtain employment in many areas, immigrants drive without licenses. Unlicensed drivers have not demonstrated their knowledge of vehicle laws or their driving competency, increasing the likelihood of accidents. Unlicensed drivers are also unlikely to have auto insurance, increasing claims paid by insurance companies and the premiums paid by licensed and insured drivers.

After the terrorist attacks, several states considered measures to restrict immigrant access to driver's licenses. Some of the terrorists were able to gain fraudulent or valid licenses. As a result, many states began reexamining driver licensing documentation procedures. Virginia recently enacted legislation that requires foreign applicants to show proof of legal residence before a driver's license can be issued. The state of Minnesota now issues licenses to immigrants that are a different color than the licenses issued to United States' citizens.

Other states, however, have expanded immigrant access to driver's licenses. In September 2003, California enacted legislation that makes driver's licenses available to undocumented immigrants by not requiring presentation of a Social Security Number (SSN). Applicants without a SSN may obtain a license with a valid birth certificate and one other document, which could be a federal Individual Tax Identification Number (INIT).

Current Maryland Law

Maryland law requires an applicant for a driver's license to submit a "birth certificate or other proof of age and identity that is satisfactory" to the Motor Vehicle Administration (MVA). MVA regulations require a foreign born applicant to provide either two primary sources of identification or one primary and two secondary sources of identification; the applicant's signature and date of birth must appear on any one of these documents. The regulations establish

21 primary sources, including a baptismal certificate, school records, a passport, a foreign driver's license, and specified immigration-related documents. The regulations establish 16 secondary sources, including a bank statement, utility bill, rental agreement, and marriage certificate.

In 2003, the General Assembly considered legislation to expand driver's license access to undocumented immigrants. As introduced, House Bill 838 would have specifically prohibited MVA from requiring a driver's license applicant to provide information on national origin or immigration status. The bill also would have expanded the types of documents MVA could accept to verify an applicant's identity, including a foreign government's national identification card, a consular identification card, and a certificate of naming issued by a religious institution, among other documents. To address concerns raised during the bill's consideration, it was amended. As amended, House Bill 838, which became Chapter 452, Acts of 2003 provided that a license applicant must either provide a SSN or certify that the applicant does not have a SSN. The law also strengthened license fraud provisions. Finally, the law established a 12-member Joint Task Force to Study Driver Licensing Documentation. The task force is required to:

- study domestic and foreign documentation related to age, identity, and residence;
- assess the extent to which documented and undocumented immigrants may not receive licenses due to documentation requirements;
- quantify the extent to which individuals without valid licenses actually drive; and
- assess the feasibility of developing processes to verify foreign documentation and to review applications to assess homeland and public safety dangers.

The task force is required to submit its recommendations to the General Assembly by December 1, 2004.

Attorney General Opinion

The Office of the Attorney General issued an opinion in September 2003 on whether MVA may require individuals with foreign identification to produce proof of legal presence in the United States as a condition of getting a driver's license. The Attorney General concluded that MVA may require a person without a domestic birth certificate to provide alternate forms of identification, which may include immigration-related documents. However, the inability to verify legal presence in the United States is not, in and of itself, a valid reason for denying a Maryland driver's license.

Implications for the 2005 Session

The task force is likely to be the impetus for legislation that will be introduced during the 2005 session. Legislation may be introduced (1) to expand the list of primary and secondary identity documents that MVA must accept, including additional immigration documents, INITs, consular identification documents, or national identification cards issued by a foreign government, (2) to alter the administrative appeals process when MVA refuses to issue a license because of questions surrounding identity documents, (3) in light of the opinion from the Office of the Attorney General, to alter the definition of State residency or to further specify how MVA may or may not request documents from license applicants that are based on national origin or citizenship status, or (4) to respond to any changes in federal immigration law. The task force may also recommend that Maryland maintain the status quo with respect to immigrant documentation for driver's licenses. As of the time of this writing, however, the task force's recommendations have not yet been finalized.

Economic and Community Development

Sunny Day Fund

Since its inception in 1988, 102 projects, including three with multiyear commitments, have received funding from the Sunny Day Fund, for a total commitment of $165.9 million. The number of projects the Department of Business and Economic Development has brought to the Legislative Policy Committee for review and comment has decreased over the last few years. With about $5.8 million in uncommitted funds available, the department anticipates presenting one new project and modifications to a few current projects in December 2004.

Overview

The Economic Development Opportunities Program (Sunny Day) Fund was created in 1988 to enhance Maryland's competitive position with neighboring states. The Department of Business and Economic Development (DBED) administers the fund, which has been increasingly reserved for large-scale projects. The Legislative Policy Committee (LPC) must review and comment on proposed Sunny Day projects before DBED can approve expenditures. The fund provides financial incentives in the form of conditional loans and conditional grants to (1) attract, retain, and expand private-sector enterprises in the State, (2) retain and expand existing public institutions, private institutions, or federal research and development institutes, and (3) establish or attract public institutions, private institutions, or federal research and development institutes to the State.

As shown in **Exhibit 1**, LPC has approved conditional loan and grant funds of $165.9 million for 102 projects in 16 different counties from the Sunny Day Fund since its inception. On a regional basis, approximately 79 percent of the projects and 87 percent of the Sunny Day funds have been targeted to the Washington and Baltimore regions. No new transactions were approved in fiscal 2004. The diminished level of activity reflects reduced appropriations due to State budgetary constraints, as well as a shift to the Maryland Economic Development Authority Assistance Fund for projects that were historically completed using Sunny Day funds.

Projects for which Sunny Day funds are requested must contain performance requirements such as job creation and retention, and capital investment. Should a project meet the established performance requirements, DBED may fully or partially forgive the loan or grant. As shown in **Exhibit 2**, full or partial forgiveness has been provided to 30 projects, amounting to $29 million of forgiveness against $32.1 million of original loan and grant totals. Alternatively, if a project fails to meet established performance requirements, the department may invoke claw-back provisions that were set forth under the funding agreement. To date, a total of 22 projects have been subject to claw-back, with a total amount repaid of $8.7 million against original funding of $17.1 million. The original funding includes transactions that may have had partial forgiveness, as well as repayment due to non-performance. Not reflected in Exhibit 2 are five companies in the portfolio that currently are in bankruptcy or have a parent that is in bankruptcy for an aggregate of $17.7 million. DBED continues to monitor the business activities of these distressed operations and will support any potential restructuring resulting in continued employment that stays within the original scope of the projects.

Exhibit 1
Approved Sunny Day Fund Projects
Fiscal 1990 through 2004

County	Number of Projects	Total Funding
Anne Arundel	9	$17,050,000
Baltimore City	12	16,413,000
Baltimore	17	28,760,000
Caroline	1	800,000
Carroll	3	4,150,000
Cecil	1	2,275,000
Dorchester	1	1,200,000
Frederick	3	7,500,000
Garrett	3	3,850,000
Harford	5	11,250,000
Howard	7	7,872,000
Kent	1	750,000
Montgomery	15	31,925,000
Prince George's	7	15,425,000
Washington	6	8,400,000
Wicomico	2	3,000,000
Statewide/Regional	9	5,300,000
Total	**102**	**$165,920,000**

Note: Although LPC has approved funding for 128 projects, the actual number of projects that received funds is reduced to 102 due to the withdrawal of 26 projects.

Source: Department of Legislative Services

Exhibit 2
Forgiven Loans and Grants and Claw-backs
Fiscal 1988 through 2004
($ in Millions)

	Number of Projects	Amount	Original Loan Amount
Forgiven Loans	30	$29.0 – forgiven	$32.1
Claw-backs	22	$8.7 – repaid	$17.1

Source: Department of Business and Economic Development

Exhibit 3 shows the balance of funds currently available in the Sunny Day Fund. Through the first quarter of fiscal 2005, $5.8 million of uncommitted funds is available. Based on anticipated principal and interest repayments, it is likely that $6.7 million will be available to support Sunny Day Fund commitments in fiscal 2005.

Exhibit 3
Maryland Economic Opportunities Fund
Sunny Day Fund
($ in Millions)

Beginning Fiscal 2005 Balance	$24.1
Principal and Interest 1st Quarter (Projected total for Fiscal 2005: $1.2 million)	0.3
Operating Expenses for Fiscal 2005	(1.1)
Committed Funds	(17.5)
Total Uncommitted Funds Available (as of October 15, 2004)	**$5.8**

Source: Department of Business and Economic Development

Economic and Community Development

Economic Development and Fiscal Accountability

A legislative proposal to require comprehensive reporting of State business incentives may be reintroduced during the 2005 session. The Department of Business and Economic Development administers the majority of business assistance programs, each having different reporting requirements. Several states have adopted extensive reporting laws that include penalties on business for noncompliance.

2004 Legislative Proposal

Legislation reintroduced during the 2004 session to establish the Economic Development and Accountability Act would have required comprehensive reporting of State business incentives and sanctioned any State agency or business that failed to comply. Senate Bill 502/House Bill 1018 would have required State agencies to develop and publish three annual reports listing company-specific State tax benefits and business subsidies. For each recipient of a State benefit (including tax abatements or credits worth more than $5,000), the Department of Business and Economic Development (DBED) would have needed to list the company name, address, phone number, the number of jobs created or lost (full-time, part-time, and temporary), the average hourly wage paid to all current and new employees at a project site, and a description of health care coverage.

The bills would have applied to all State agencies; however, since DBED administers the majority of business assistance programs, this paper focuses solely on DBED's reporting requirements.

Information Disclosed

DBED is statutorily required to submit annual reports for all its financing programs except the Maryland Economic Adjustment Fund and the Enterprise Investment Fund. The law has more extensive requirements for certain programs; that is, some reports describe the amount of funds provided for each project, the purpose of the project, and economic development measures. The information required for other programs is vague. None of the reports provide the average hourly wage paid to all current and new employees at a project site or a description of health care benefits, as would have been required by the legislation. However, DBED does provide additional information beyond what is mandated by law, as shown in **Exhibit 1**.

Exhibit 1
Department of Business and Economic Development
Information Disclosed

Annual Report by Program	Statutory Requirements	Additional Information Disclosed
MEDAFF	Number, amount, use, and economic benefits of financial assistance and grants	Number of jobs created and retained
One Maryland	Status of the fund	Amount of funds per project and location of project
Sunny Day	Financial status and a summary of its operations; status of account disbursements; and information on job creation, capital investment, and lower than expected economic development measures	Amount and use of funds; recipient’s name; delinquency and default status; and information on job creation, capital investment, forgiven loans, and claw-backs
MSBDFA	Condition and operations of the fund	Total number of loans and grants, amount and use of funds, and delinquency and default status
MIDFA	Condition and operations of the fund	Total number of loans and grants; amount of funds; and information on exposure, leverage, and geographical distribution
MEAF	None	None
EIF	None	None

MEDAAF – Maryland Economic Development Assistance Authority Fund
MSBDFA – Maryland Small Business Development Financing Authority
MIDFA – Maryland Industrial Development Financing Authority
MEAF – Maryland Economic Adjustment Fund
EIF – Enterprise Investment Fund

Source: Department of Business and Economic Development, Department of Legislative Services

DBED also prepares the Blue Book, a document that summarizes the same information as the annual reports but also provides a list of approved activity with the name of the company receiving the subsidy. The Blue Book is an internal report; however, the Department of Legislative Services and the Department of Budget and Management are provided copies.

Although DBED provides this information, a recent audit of their fiscal 2003 performance measures disclosed significant problems regarding data accumulation and reporting processes. The audit tested six performance measures for reliability, including the number of new and retained jobs; however, all six measures were determined to be unreliable and, therefore, were unable to be certified as reasonably accurate. The primary reason for the lack of certification was the absence of formal quality assurance processes to review and verify the accuracy of the performance results throughout the fiscal year. For example, the job creation and retention projections were inaccurate due in part to significant double counting, numerous reporting errors, and unsupported jobs claims. In addition, reported results were sometimes based on projects for which DBED had approved funding but the company did not yet accept DBED's offer.

In addition to the assistance provided by the State's financing programs, numerous business tax credits have been adopted by the General Assembly in recent years to encourage business development. While numerous credits are now on the books, little information is known as to the actual credits that are awarded or claimed. This lack of information is primarily due to the confidentiality of tax returns, the data collected by certifying agencies and the Comptroller, a lack of uniform reporting requirements, and administrative limitations. Without additional information being collected or made available, it will continue to be difficult for the General Assembly to evaluate the effectiveness of these credits.

Comparison of State Disclosure Requirements

State laws governing disclosure of economic development assistance vary widely. Several states, like Maryland, require reports to the legislature that describe the annual disbursement of economic incentives; in some cases, the state prescribes specific items that must be disclosed, such as the recipient's name and the value of the incentive. The most extensive reporting laws are in Illinois, Minnesota, and Maine. Illinois recently adopted the Corporate Accountability for Tax Expenditures Act, which catalogues all state subsidies and requires annual progress reports from companies that receive tax exemptions or credits (excluding tax increment financing) or other forms of assistance. If a business fails to report the required employment and wage information, development assistance will be suspended. **Exhibit 2** highlights the reporting laws in selected states.

Emerging in recent years is a trend toward requiring more specific information regarding the use of state economic benefits and, in some cases, consolidating that information. For example, the Nebraska State Tax Commissioner provides an annual report that summarizes activity for each tax credit, as well as sales and use tax refunds, and provides data such as the total amount claimed per credit, distribution by type of recipient (corporate and individual) and amount recaptured. Some of these reports are also published on departmental web sites. While Maryland requires reporting for economic development subsidies (both tax and nontax), the disclosure requirements are inconsistent and, with the exception of some financing programs, are not specific. Legislation is likely to be reintroduced during the 2005 legislative session to expand the disclosure of information relating to economic development incentives.

Exhibit 2
Selected State Disclosure Laws

State	Type of Assistance Disclosed	Company-specific Information Disclosed	Penalties for Noncompliance
Connecticut	State development assistance for businesses with 25+ full-time employees requesting $250,000 or more	Actual and projected jobs created and amount of assistance	None specified
Minnesota	State development assistance over $75,000	Number of jobs created, hourly wage for each job, sum of wages, and cost of health insurance	$100 per day on companies ($1,000 maximum)*
Nebraska	Property tax exemptions, sales and use tax refunds, and employment and investment tax credits	Project size (number of employees and amount of investment) for certain tax credits	None specified
Ohio	Local property tax exemptions and compliance with local enterprise zone agreements	Job creation and retention requirements and value of exemption	Embargo on future agreements
North Carolina	Tax credits for training, research and development, and machinery and equipment	Amount of credit per company, number of jobs created in designated development zone, and number of jobs provided to zone residents	None specified (NC Department of Revenue is responsible for report)

* Fine is imposed on a company that fails to report within 14 days after a warning is sent.

Source: Various state statutes.

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Economic and Community Development

Affordable Housing Shortage

The State as well as the country is facing an affordable housing shortage. The Governor's Commission on Housing Policy anticipates completing its work by December 31, 2004, which may result in legislative proposals to address this concern. Further, the Department of Housing and Community Development is exploring new and innovative ways to enhance its loan program without relying on additional State resources.

Background

The State as well as the country is facing an affordable housing shortage. To address the shortage, Governor Robert L. Ehrlich, Jr. issued an executive order in March 2003 that created the Governor's Commission on Housing Policy. The commission submitted its interim recommendations to the Governor on September 30, 2004. Over the next three months, the commission will continue to discuss, deliberate, and finalize its top recommendations. The final recommendations are due to the Governor on December 31, 2004. In addition to the commission's recommendations, the Department of Housing and Community Development (DHCD) is exploring ways to use its existing funding to increase its affordable housing loan program capacity without relying on general funds.

Governor's Commission on Housing Policy

The Governor's Commission on Housing Policy was charged with making recommendations to the Governor for "specific and measurable actions … to increase and preserve quality affordable workforce housing in all Maryland communities … ." The interim report provides a synopsis of the commission's activities and a list of the emerging top 10 recommendations. According to a study completed by DHCD's Office of Research and included with the interim report, there is an acute shortage of rental housing for workforce and low-income families, seniors, and individuals with disabilities at Supplemental Security Income (SSI) levels. As of 2000, Maryland had a deficit of approximately 125,000 affordable and available workforce rental housing units. An affordable unit is defined as a unit where the renter earns less than 50 percent of Area Median Income (AMI) and is spending less than 30 percent of his or her gross income on rent. As shown in **Exhibit 1**, the workforce affordable rental housing shortage in Maryland is projected to grow by an additional 26 percent by 2014, reaching a high of approximately 157,000 units.

Exhibit 1
Projected 2014 Affordable Rental Housing Shortage in Maryland

Household Type	Shortage	Percent of Total
Families	103,100	66%
Seniors	25,000	16%
Individuals with Disabilities	28,800	18%
Total	**156,900**	**100%**

Note: The projected shortage is based on the number of renter households earning less than 50 percent of AMI and paying more then 30 percent of their gross income for rent. The projection takes into account population growth and assumes no new additional rental housing production by DHCD.

Source: Department of Housing and Community Development

Over the past five years, DHCD has financed the production on average of approximately 2,700 units of affordable rental housing units annually. If DHCD continues to produce at this rate, the projected rental housing shortage will be reduced by only 27,000 units over the next 10 years, leaving a total rental housing shortage of approximately 130,000 units by 2014. In an effort to close the gap, two of the commission's preliminary top recommendations include:

- the creation of a dedicated funding source for affordable housing – the source has not been identified at this time; and

- a requirement that local jurisdictions with planning and zoning authority develop a housing policy which addresses the supply of land, properly zoned for residential purposes and sufficient to accommodate growth including equitably addressing affordable housing for all Maryland citizens at all incomes.

Other recommendations include creating a pilot program to develop mixed income housing developments (homeownership and rental), reviewing State surplus property to identify land appropriate for all types of housing, and creating a bridge subsidy program for individuals with disabilities. Some recommendations target units at income levels above 50 percent of AMI; theoretically, this will help close the gap by creating additional capacity and enabling households to move out of lower income units and into the new units. Legislation may be introduced during the 2005 session to enact some of the recommended policy changes.

Loan Program Enhancements

In addition to the commission recommendations, DHCD is exploring ways to use its existing funding to enhance its loan program capacity without relying on additional State resources. The goal is to finance additional multi-family rental units using existing DHCD controlled resources with no new State funds. DHCD's controlled resources include the State-funded Rental Housing Program, the Partnership Rental Housing Program, the federal HOME program, the federal Low Income Housing Tax Credits, and taxable and tax-exempt revenue bonds. The additional enhancements are still under development but may include leveraging rental housing funds with tax-exempt revenue bonds and optimizing the number of 9 percent tax credit projects. If implemented, DHCD estimates that the enhancements may create approximately 900 additional multifamily rental units per year, increasing production from approximately 2,700 to 3,600 units annually.

Other ideas include improving DHCD's overall revenue bond program by streamlining the underwriting process, issuing bonds every 60 days, and offering flexible terms such as a locking interest rate product. The enhancements are intended to supplement the department's current production and to increase DHCD's production of affordable workforce rental housing for families, seniors, and individuals with disabilities at SSI levels. None of the enhancements require the enactment of legislation.

In conclusion, significant policy changes related to providing increased affordable housing are still under development and may not become evident until after the commission's final recommendations to the Governor on December 31, 2004. At that time, legislation may be introduced to enact some of the recommended policy changes. Additionally, the department's plan to reduce its overall reliance on general funds will not significantly change the department's ability to provide affordable housing to the very poor, since no general funds are currently supporting the capital grant and loan programs.

Economic and Community Development

Hurricane Isabel Disaster Relief Act

The Hurricane Isabel Housing Rehabilitation and Renovation Program has provided approximately $7.5 million in low-interest loans and other assistance to victims hit the hardest by Isabel. Since additional assistance funds may be needed, the Department of Housing and Community Development is working toward finding other resources. In response to complaints about the handling of insurance claims, the Maryland Insurance Administration has submitted recommendations to the Maryland Congressional Delegation for improvements to the National Flood Insurance Program.

The Hurricane Isabel Housing Rehabilitation and Renovation Program

Chapters 7 and 8 of 2004 (Senate Bill 415/House Bill 3) create the Hurricane Isabel Housing Rehabilitation and Renovation Program in the Department of Housing and Community Development (DHCD) to provide streamlined assistance to residents whose homes were destroyed or severely damaged by Hurricane Isabel in September 2003 and whose insurance coverage and other financial resources fell short of meeting their housing needs. The program restructures existing State housing financial aid programs and creates other types of financial assistance so that eligible homeowners can receive assistance from DHCD under three basic forms: low-interest loans for a first or subordinate mortgage to rehabilitate or renovate a primary residence; credit enhancement assistance to maximize eligibility for a loan obtained in the private market to rehabilitate, renovate, or replace a residence; and buy-down assistance to reduce for a limited period of time the amount a borrower pays on a loan obtained in the private market or from DHCD.

Financial assistance under the program commenced March 29, 2004, and terminates May 31, 2005. DHCD issued a preliminary report on September 30, 2004, and anticipates issuing a final report by September 30, 2005, on the implementation of the program.

Preliminary Report on Assistance Provided by DHCD

DHCD reports as of September 2004 that of the $7.5 million in State funds dedicated to the program, nearly all of that amount ($7,187,876) has been committed as low-interest loans. Under this assistance program, DHCD has made 114 loans (26 percent of the 432 total applications received), as shown in **Exhibit 1**, primarily to residents of the counties hit hardest by Isabel: Anne Arundel County, Baltimore County, and Dorchester County. DHCD reports that it has given priority to families who were relocated into temporary housing by the Federal Emergency Management Agency (FEMA), giving particular priority to senior citizens and families with young children in trailers. The average funded amount is $63,052. Of the remaining applications, 56 percent require no State funding and are closed, and 18 percent are still pending review. With only 4 percent ($312,124) of the dedicated funds remaining, 75 applications currently under review, and ineligible cases and private lender referrals running at approximately 53 percent, DHCD estimates that an additional $3.7 to $5.2 million will be needed to meet the remaining demand. DHCD reports that under the Governor's direction, DHCD is working with the Department of Budget and Management to accommodate this need from other departmental resources without making additional requests of the legislature.

Exhibit 1
Maryland Department of Housing and Community Development
Implementation of Hurricane Isabel Disaster Relief Act
Application State Summary
As of September 24, 2004

		Applications Funded		Applications Closed (No State Funding Required)			Applications Under Review	
		State Loans Committed/Closed						
County	**Total Applications Received**	**Number**	**Dollar**	**Ineligible**	**Inactive**	**Referred to Private Lenders**	**Under Construction Review**	**Under Underwriting Review**
Anne Arundel	85	24	$1,759,767	32	5	10	8	6
Baltimore City	36	3	48,217	26	0	2	4	1
Baltimore	144	41	2,353,165	54	3	23	16	7
Calvert	6	2	186,417	1	1	1	1	0
Cecil	8	2	200,000	3	1	0	1	1
Charles	1	0	0	1	0	0	0	0
Dorchester	67	24	1,549,286	32	0	2	6	3
Garrett	1	0	0	1	0	0	0	0
Harford	7	0	0	6	0	0	0	1
Kent	9	1	100,000	3	1	1	2	1
Prince George's	31	2	51,577	17	1	2	6	3
Queen Anne's	9	3	160,183	3	1	0	1	1
St. Mary's	10	4	310,616	3	0	1	0	2
Somerset	10	4	208,448	3	0	0	2	1
Talbot	8	4	260,200	2	0	1	1	0
Totals	**432**	**114**	**$7,187,876**	**187**	**13**	**43**	**48**	**27**

Source: Maryland Department of Housing and Community Development

Under the credit enhancement assistance program, DHCD reports that no funds have been expended to date because lenders participating in this program have found that applicants already have sufficient value in their properties to meet loan to value requirements and thus do not need the credit enhancement available under the program. Under the buy-down assistance program, DHCD reports that it has received 10 applications (nine from Baltimore County and one from Anne Arundel County) and that it has been able to fund this assistance using resources totaling $140,465 from the Maryland Housing Finance Program.

DHCD also reports that it has facilitated the delivery of other forms of housing assistance to Hurricane Isabel victims by utilizing federal HOME grants and Maryland Affordable Housing Trust grants and by partnering with interfaith groups and local housing agencies as well as various other local, State, and federal agencies.

Maryland Insurance Administration Submits Recommendations for Improvements to the National Flood Insurance Program

The Maryland Insurance Administration's (MIA's) role in the event of an emergency that involves insurance is to provide assistance to citizens by informing them of their rights and coverages under their insurance policies and to assist them when they have problems with their claims. In the weeks and months following Hurricane Isabel, staff at MIA assisted affected citizens in filing claims and resolving complaints. However, MIA found that a vast majority of complaints it received concerned the National Flood Insurance Program (NFIP) policies and coverage. Since NFIP is a federal program and under the jurisdiction of Congress and regulations promulgated by the Federal Emergency Management Agency (FEMA), MIA is limited in the amount of assistance it can provide to citizens with complaints regarding those policies. In order to address these complaints, MIA submitted a report to the Maryland Congressional Delegation which included a list of recommendations for improvements to NFIP with respect to policy sales, policy coverages, claims processes, education requirements for buyers and sellers, and notice requirements.

NFIP Reauthorized

In June 2004, NFIP was reauthorized and extended through September 30, 2008. NFIP is managed by the Mitigation Division of FEMA. Congress first created NFIP in 1968 in response to the rising cost of taxpayer-funded disaster relief for flood victims and the increasing amount of damage caused by floods.

Congress included language in the reauthorization bill that requires the Comptroller General of the United States to conduct a study of the adequacy of the scope of coverage provided under flood insurance policies in meeting the intended goal of Congress that flood victims be restored to their pre-flood conditions; the adequacy of payments to flood victims under flood insurance policies; and the practices of FEMA and insurance adjusters in estimating losses incurred during a flood and how such practices affect the adequacy of payments to flood victims. The results of the study are due by June 30, 2005.

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Business Regulation

Unemployment Insurance

The level of Maryland's Unemployment Insurance Trust Fund is about $130.5 million below the level that is required to prevent triggering the unemployment surcharge on employers, resulting in a 0.8 percent surcharge for calendar 2005. The Unemployment Insurance Funding Task Force was established during 2003 to examine the fairness of the existing charging and taxation system and eligibility and benefit provisions and the need to alter the current system to maintain the trust fund at a level sufficient to meet benefit needs. The task force's recommendations, anticipated by the end of December 2004, may consist of a proposal that (1) improves the solvency of the trust fund, (2) reduces the amount of noncharging leakage, (3) more equitably charges employers, and (4) provides an acceptable level of benefits.

Status of the Unemployment Insurance Trust Fund

Under federal law each state must maintain an unemployment insurance trust fund from which unemployment benefits are to be paid. In Maryland, a surcharge triggers on the following January 1 when the Maryland Unemployment Insurance Trust Fund balance on September 30 of any year is less than 4.7 percent of the total taxable wages in covered employment for the preceding four calendar quarters. The surcharge varies from 0.1 to 2 percent, with the amount depending on the degree to which the trust fund balance is underfunded.

During fiscal 2004 tax revenues amounted to approximately $413 million and benefit payments to approximately $459 million. With benefit payments exceeding tax revenues for several years, the level of the trust fund has been depleted to a level that necessitates the assessment of a surcharge to replenish the balance. On September 30, 2004, the balance in the trust fund was $705.5 million, $130.5 million below the level that is required to prevent triggering the State's surcharge, an improvement over last year's shortfall of $176 million. Since the balance of the trust fund was below the required $836 million, the State's employers will be assessed a 0.8 percent surcharge in calendar 2005, an improvement over the calendar 2004 surcharge of 1.1 percent. This translates into an additional cost to employers of $68 per employee per year.

Prior to calendar 2004, the last year a surcharge was assessed was in calendar 1996 (0.6 percent). A surcharge was also assessed in calendar 1993, 1994, and 1995 (1.7 percent, 1.7 percent, and 1.1 percent, respectively). Legislation was enacted in 1994 and 1995 to bypass the statutory surcharge schedule in order to reduce the surcharge to a lower level.

Maryland is not the only state that will assess a surcharge on its employers for calendar 2005. Approximately 21 other states are assessing surcharges on their employers to replenish their trust funds. Moreover, during calendar 2004 the economic downturn significantly impacted seven states' unemployment systems that faced bankruptcy, forcing them to either seek bailout loans from the federal unemployment insurance trust fund managed through the U.S. Department of Labor or float bonds. Unless loans are paid back by September 30 of the year borrowed, interest is charged, adding to the cost to taxpayers (through general funds).

Unemployment Insurance Funding Task Force

Knowing that the assessment of a surcharge on the State's employers was inevitable in the near future, the General Assembly passed Chapter 269 of 2003 to establish the Unemployment Insurance Funding Task Force for the purpose of reviewing Maryland's overall unemployment insurance system. Specifically, the task force is charged with examining the fairness of the existing charging and taxation system; the fairness of the existing eligibility and benefit provisions; the need for altering the current system of charging and taxation in order to maintain the trust fund at a level sufficient to meet benefit needs; and the impact of changes in the national and State economies and their relationship to changes in the trust fund. The task force is comprised of legislators, representatives of business and labor, a State agency representative, an economist, and an academic professional.

Since the task force did not complete its work during the 2003 interim, the task force issued an interim report in February 2004 with a recommendation to continue for another year. Subsequently, the General Assembly passed Chapter 260 of 2004, charging the task force to issue a final report on or before December 31, 2004, the same date the task force terminates.

During the 2004 interim, the task force held several meetings with discussion focusing on alternatives that impact the taxation system, the noncharging provisions, and benefits and eligibility requirements. The task force heard from the Secretary of Labor, Licensing, and Regulation about the need to find a solution that resolves the financial solvency of the trust fund in the long term; analyzed information regarding open and closed accounts by industry; heard from business sectors about their unemployment insurance obligations in Maryland, as compared to other states; heard from worker-representatives about the alternatives that the task force is considering; discussed tax proposals which were initiated as a way to "experience rate the surcharge" using various tax schedules depending on the level of the trust fund; and reviewed the Maryland Office of Unemployment Insurance's proposal. Further, some task force members participated in a workgroup to develop a compromise package of recommendations.

The task force is planning to meet through the end of November 2004 and issue its final report by the end of the year. The task force's recommendations may consist of a proposal that (1) improves the solvency of the trust fund, (2) reduces the amount of noncharging leakage, (3) more equitably charges employers, and (4) provides an acceptable level of benefits.

Taxation

Under current law, monies are paid into the trust fund through a tax on employers paid on the first $8,500 of each employee's annual income (the taxable wage base). The tax is experience rated, with employers with the least turnover paying the minimum tax of 0.3 percent and employers with the highest turnover paying a maximum tax of 7.5 percent. When a surcharge is assessed in a calendar year, all employers pay the same surcharge percentage. The task force is considering alternatives that would raise the minimum tax rate; increase every step of the tax table by the same amount; collapse the tax table into 0.2 or 0.3 percent intervals; raise or index the taxable wage base; experience rate the surcharge; and create different tax rate tables to be used in different economic climates.

Noncharging Provisions

The ability of the tax structure to provide adequate trust fund reserves to avoid a surcharge is affected by several factors relating to the "noncharging" or partial charging of employers for benefits claimed by former employees of those employers. By not charging particular employers for these benefits, the costs are spread to all employers. Noncharging circumstances, also called "leakage," under current law include (1) not charging an employer's account for a former employee's subsequent unemployment after re-employment, particularly where the employee requalifies for benefits after voluntarily quitting the earlier employer (approximately $51 million), (2) the noncharging of closed businesses (approximately $45 million), and (3) the partial charging of businesses with experience ratings (turnover rates) that would theoretically place the businesses at a tax rate greater than the maximum tax rate that can be charged under the tax schedule (approximately $61 million). Employer groups have expressed opposition in changing the voluntary quit noncharging provision, acknowledging that this means that some leakage will continue. However, the task force is considering alternatives that would reduce the other forms of leakage, including altering the formula for determining the tax rate for new employers and increasing the maximum tax rate.

Benefit and Eligibility Requirements

Under current law, benefits range from $25 to $310 per week, with the amount based on the claimant's high-quarter wages for the first four of the last five completed calendar quarters, up to maximum qualifying wages of $6,700 in a calendar quarter and $10,080 in a four-quarter period. The maximum weekly benefit (increased from $280 under Chapter 239 of 2002) replaces approximately 43 percent of the State's average weekly wage. The individual may earn $90 while still receiving the full weekly benefit amount. In addition, a claimant is paid $8 per week for each child who is supported by the claimant, not to exceed five dependents. The benefit plus the dependents' allowances may not exceed the highest allowable weekly benefit. Claimants may receive benefits for up to 26 weeks. An individual must be able to work, available for work, and actively seeking work. Claimants must be available for customary hours of work in their occupation. The task force is considering alternatives that would alter the base period to be the "most recently completed four quarters" if an individual has insufficient wages in the base period to qualify; change to a "variable duration of benefits"; and alter the amount of dependents' allowances. Other alternatives that have been strongly opposed by certain groups include imposing a one-week waiting period for a claimant to receive a first check and extending benefits to part-time workers.

Business Regulation

Horse Racing

The horse racing industry in Maryland continues to experience changes and challenges. Purse supplements are higher in neighboring states. In Pennsylvania, 12 percent of revenue from slots will go toward enhancing its horse racing industry. While track improvements are being made at Pimlico and Laurel Park, another racetrack (Rosecroft Raceway) is facing financial troubles and has been involved in civil lawsuits.

Industry Outlook

For the second consecutive year, a horse emerged to capture the nation's imagination. Like Funny Cide in 2003, Smarty Jones nearly won Racing's Triple Crown in 2004. Once again, there was elevated interest in horse racing. Although live horse racing in the United States has not significantly increased in popularity, pari-mutual wagering has remained steady because of alternative wagering mechanisms including simulcasting, off-track betting, and telephone accounts.

Maryland's complex and heavily regulated horse racing industry continues to experience changes and challenges. The biggest change sought by the industry – slot machines at racetracks with a portion of the proceeds benefiting racing – failed during the 2003 and 2004 sessions. More money for purses is needed to revitalize the industry, and the racing industry believes the best way to increase purses is to locate slot machines at racing tracks. According to industry experts, the amount of purses determines the number of horses racing, which then determines quality of racing.

Maryland's Racing Industry at a Glance

Currently most thoroughbred racing in Maryland occurs at Pimlico in Baltimore City and Laurel Race Track in Anne Arundel County, both run by the Maryland Jockey Club. All standardbred racing occurs at Rosecroft in Prince George's County and Ocean Downs in Worcester County, which are independently owned. The State Racing Commission licenses each facility, and State law limits the number of licensees. An additional track license was awarded to Allegany Racing in Allegany County, which is owned by the same persons that own Ocean Downs. Allegany Racing has yet to begin construction and most likely will not begin construction until slot machines are approved with Allegany Racing as one of the designated sites. Ocean Downs has also recently opened an off-track betting establishment in Cambridge.

State Assistance and Actions Regarding Maryland Racing

Horse racing in neighboring states is succeeding because other forms of gaming, primarily slot machines, enhance purses. Another way to enhance purses includes government grants. In three of the past five years, the General Assembly authorized the use of State funds to enhance racing purses. In 2001 there was no authorization because of continued industry infighting. In 2003, in anticipation of slot machines, the industry did not pursue other types of State assistance to enhance purses. Even with the State's past contributions to the racing industry, **Exhibit 1** shows that purse supplements in Maryland are significantly lower than Delaware and West Virginia. The purse amounts for Maryland largely come from money wagered on Maryland races, and also include the purse supplements. The pressure on Maryland racing is exacerbated by the fact that purse supplements alone in Delaware and West Virginia have exceeded Maryland purses.

Another reason for the decline in Maryland racing is the condition of its facilities, most notably Pimlico and Laurel racetracks. In 2000 the General Assembly established the Racing Facility Redevelopment Program to assist horse racing facilities with capital improvements. The assistance was to be provided through a revenue bond fund, funded mostly through increased take-outs from bettors and uncashed winning tickets. The program was repealed this year because no bonds had ever been issued to finance capital improvements.

Exhibit 1
Purse Supplements for Maryland, Delaware, and West Virginia

	1999	2000	2001	2002	2003
Maryland Racing					
Purses	$57,641,144	$56,977,573	$53,949,589	$47,355,640	$47,555,931
Purse Supplements	$10,000,000	$10,000,000	0	$ 3,700,000	0
Delaware Racing					
Purse Supplements	$51,384,183	$53,688,700	$58,168,600	$62,612,500	$55,776,300
West Virginia Racing					
Purse Supplements	N/A	$35,007,713	$48,126,134	$57,428,355	$62,688,145

Source: Department of Legislative Services, Maryland Racing Commission Annual Reports, Delaware State Government Web Page, West Virginia State Government Web Page

The Pennsylvania Effect

The most recent significant event affecting Maryland may have occurred in Pennsylvania. As shown in Exhibit 1, Maryland's racing industry was already experiencing pressure from

Delaware and West Virginia. This past summer, Pennsylvania legalized the placement of 61,000 slot machines in specific locations across the state. The number of machines far exceeds the number of machines in Delaware and West Virginia, which means the amount of revenue generated in Pennsylvania may be substantial. Twelve percent of the daily revenue will go to the Pennsylvania Racehorse Development Fund. West Virginia designates 8 percent of slot machine revenues to purses, while Delaware designates 11 percent for purses.

As a result of slot machines, Pennsylvania could eclipse Maryland as the major racing state in the region. For example, per day purses at Philadelphia Park, home of Smarty Jones, are projected to go from $135,000 to $350,000 or higher. Purses at Laurel Park in Maryland for 2003 were $172,549 per day. There is concern in the Maryland racing community that many horse breeders and horsemen will be lured to Pennsylvania.

Rebuilding and Reconstituting Maryland Racing

During 2002, in an attempt to breathe new energy into Maryland horse racing, the Maryland Jockey Club sold a majority interest to Magna Entertainment Corporation, a company with racing interests across the nation. The sale gave Magna control over Pimlico and Laurel racetracks, a training facility in Bowie, and ownership of the Preakness. To gain racing commission approval, Magna assured that $15 million would be spent on track improvements. Magna is meeting its obligations and is proceeding with renovations to barn areas, roadways, landscaping, and water and electrical systems at Pimlico and is completely renovating Laurel Park, although not as quickly as the commission would like.

One issue that surfaced during the 2003 session and continued through the 2004 session was Magna's ownership of the Preakness. Legislators were alarmed to learn that Magna actually owned the Preakness and could move the "crown jewel of Maryland racing" out of the State. Officials from Magna have repeatedly assured the General Assembly and the public that the Preakness will remain in Maryland.

While there seems to be some stability in the management of the State's major thoroughbred tracks, Maryland's major standardbred track, Rosecroft Raceway, is in serious financial trouble. In mid-2002, the owners of Rosecroft Raceway decided to sell their beleaguered harness track. Since then Rosecroft has been courted by Centaur, Inc.; Centaur, Inc., partnered with Delaware North; Northwind Racing, LLC; and the family of Peter Angelos. As a result of these multiple suitors over the past two years, the owners of Rosecroft have been involved in civil suits, further debilitating the industry.

Other issues that have surfaced during 2004 include the ending of the 80/20 revenue sharing agreement between the Maryland Jockey Club and Rosecroft. For the past several years and ending in June 2004, out of all revenues realized by both groups, the Jockey Club received 80 percent and Rosecroft received 20 percent. The agreement also allowed the Jockey Club's tracks to receive simulcast signals after 6:15 p.m. and allowed Rosecroft to receive simulcast signals during the day. Under a new agreement that expires on December 31, 2004, Rosecroft simply pays the Maryland Jockey Club 12 percent of its revenue.

Business Regulation

Retail Electric and Gas Restructuring

As competitive electric markets develop, several issues may come before the General Assembly for further review during the 2005 session including allowing counties and municipalities to aggregate demand, establishing an energy-saving investment program, and regulating total electricity rates. Further, a proposal is anticipated to combine the weatherization component of the Electric Universal Service Program with a similar program under the Department of Housing and Community Development.

Implementation of Electric Restructuring and Standard Offer Service

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, introducing "customer choice" of an electric supplier effective July 1, 2000. The electricity industry provides three main services: the generation of electricity, the transmission of that electricity on high-capacity lines to distribution networks, and the distribution of the electricity to customers. Before deregulation, the local electric utilities "bundled" these three services and provided them to their customers within their geographically defined monopoly service territories. The generation component is being deregulated; the transmission and distribution components remain regulated as monopoly services.

Two mechanisms were set in statute to protect customers from rate swings during the transition to customer choice: a mandated rate reduction (from 3 to 7.5 percent of base rates) and a rate cap through July 30, 2003. Settlement agreements negotiated in 1999 between the utilities and interested parties established the actual amount of the rate reduction and extended the date for how long the rate caps are in place.

Customer choice allows the customer to purchase electricity generated by other sources and have the electricity delivered over transmission and distribution lines of the local electric utility. However, the customer has the option to remain with the supplier of the local electric utility under the "standard offer service" (SOS). Another mechanism, set in statute to ensure a smooth transition to customer choice, requires the Public Service Commission to extend the local electric utilities' SOS obligation if, as of July 2003, the retail electricity supply market is not competitive. Under an extension, although the SOS obligation continues, rate caps on that service expire. Customers of SOS pay a bidded market price that is sufficient to provide the electric company with the opportunity to recover verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return.

The commission determined in April 2003 that the market in Maryland had not developed to the point that the commission could relieve the utilities of their SOS obligation. Subsequently, a new settlement was negotiated to extend the obligation of the utilities to provide the SOS between 2004 and 2012, depending on the utility. If a customer does not choose a supplier by that time, the customer will receive default service, a safety net service that ensures that customers receive uninterrupted power if for any reason they are temporarily without a supplier. Further, under the settlement, the commission may review and approve final bid results of the utilities' procurement of wholesale electric supply, retail prices charged to customers, and enrollment activity. SOS offering is based on an annual procurement of a portfolio of wholesale bids ranging in length from one to three years.

In April 2004, the commission reviewed the results of the competitive wholesale procurement bid process for SOS in the territories of the four investor-owned utilities in which the caps were to expire at the end of June 2004. Of the 25 bidders in the process, 14 suppliers won some portion of the load. Generally, in the PEPCO service territory, residential customers experienced a total annual bill increase of 16 percent, effective July 1, 2004 (26 percent in the SOS supply part of the bill). Conectiv residential customers had a smaller increase of 12 percent on their total annual bill (19 percent increase in the SOS supply part of the bill).

About 19 licenses have been granted to suppliers, brokers, aggregators, and/or marketers that serve residential customers, 45 licenses to those that serve commercial customers, and 39 licenses to those that serve industrial customers. Nevertheless, the vast majority of electricity sold in the State is produced by conventional central station power plants of the State's four investor-owned utilities. For generation, as of September 30, 2004, 2.4 percent of residential customers (or 3.1 percent of the load) and 6 percent (or 42.4 percent of the load) of commercial and industrial customers have switched to an electric supplier other than the SOS supplier.

Exhibit 1 displays the reduction of rates and the timing for the cap or freeze negotiated with six of the utilities that provide in-state electric services. Further, the exhibit displays the timing of the obligation of the investor-owned utilities to provide the SOS and the effect of recent price changes.

Exhibit 1

Electricity Distribution Service (DS) and Standard Offer Service (SOS) Rate Restrictions

BGE (Baltimore Gas and Electric Co.)	Rate Reduction: average 6.5% for *residential* only Rates Frozen for DS and SOS: *residential* through 6/30/06; *commercial* through 6/30/04 (expired); *large industrial* through 6/30/02 (expired) Market-based *commercial* prices effective 7/1/04: average 17 to 20% increase in total annual bill SOS obligation: *residential* through 5/31/10; *commercial* through 5/31/06 or 08; *large industrial* through 5/31/05 or 06 Choice Activity*: *residential* 0%; *commercial* and *industrial* 2.3%

Exhibit 1 (continued)

PEPCO† (Potomac Electric Power Co.)	Rate Reduction: 7% Rates Capped for DS and SOS: *residential* and *commercial* through 6/30/04 (expired) Market-based prices effective 7/1/04: *residential* average 16% increase in total annual bill (26% increase in SOS); *commercial* average 16 to 35% increase in total annual bill SOS obligation: *residential* through 5/31/08; *commercial* through 5/31/06 or 08; *large industrial* through 5/31/05 or 06 Choice Activity*: *residential* 9.6%; *commercial* and *industrial* 18%
Conectiv† (Delmarva Power and Light Co.)	Rate Reduction: 7.5% for *residential* only Rates Frozen for DS and SOS: *residential* through 6/30/04 (expired); *commercial* through 6/30/03 (expired) Market-based prices effective 7/1/04: *residential* average 12% increase in total annual bill (19% increase in SOS); *commercial* average 5% decrease to 12% increase in total annual bill SOS obligation: *residential* through 5/31/08; *commercial* through 5/31/06 or 08; *large industrial* through 5/31/05 or 06 Choice Activity*: *residential* 0.1%; *commercial* and *industrial* 6.3%

*Choice Activity: Percent of customers who have switched to a supplier other than the SOS, as of 9/30/04.
†PEPCO and Conectiv merged in August 2002 to be subsidiaries of PEPCO Holdings, Inc.

Source: Public Service Commission

Anticipated Legislative Proposals

Several legislative proposals from last session may be reintroduced during the 2005 session, including allowing counties and municipalities to aggregate demand, establishing an energy-saving investment program, and regulating total electricity rates. Further, a proposal is anticipated to combine the weatherization component of the Electric Universal Service Program with a similar program under the Department of Housing and Community Development (DHCD).

Aggregation by Counties and Municipalities

Aggregation allows customers to benefit from competition by pooling with other customers to negotiate discounted prices for electric generation. The aggregator is not the supplier but rather an entity through which market-based suppliers may bid on selling electricity to the residential customers whom the aggregating group includes. Under the electricity restructuring law, a county or municipality may not act as an aggregator for its residents unless the commission determines there is not sufficient competition within the boundaries of the county or municipality. However, a county or municipality may combine governmental units for the purchase of electricity for use by the governmental units. For example, a county could form a cooperative that would include its school system buildings and other government buildings. Several counties have taken steps to do this, including Montgomery, Baltimore, Frederick, Carroll, and Anne Arundel. The State has also formed a cooperative to include all State agencies and has invited counties to join that entity.

Senate Bill 12/House Bill 23 of 2004 would have authorized counties or their municipalities to act as an aggregator that purchases electricity on behalf of its citizens under an opt-out approach. Under this approach, a customer is deemed to have given permission to the county or municipality to act as the aggregator if, after receiving notice, the customer explicitly grants permission by return notice, or if the customer fails to return notice within 30 days after receipt. Several jurisdictions expressed interest in acting as opt-out aggregators (Takoma Park, Greenbelt, Bowie, and Ocean City). Ohio and Illinois are the only two states that currently allow opt-out aggregation. The Senate Finance Committee voted unfavorably on its bill, while the House Economic Matters Committee did not take any action. Prior introductions offered different approaches. House Bill 24 of 2003 would have created a pilot program that included only Montgomery and Price George's counties. Senate Bill 37 of 2003 would have allowed a county or municipality to act as an aggregator to purchase electricity on behalf of its citizens under an opt-in approach, under which the government entity chooses the electric provider for a group of citizens who have affirmatively elected to join the group.

Energy-saving Investment Program

Utilities had diminished or eliminated their energy efficiency programs even before the passage of the electricity restructuring law. However, the Maryland Energy Administration recently developed two programs (the Energy Star Marketing Campaign and the Contractor Training Program) using $1 million provided from the merger of PEPCO and Conectiv. The Energy Star project educates consumers about the benefits of purchasing Energy Star appliances and homes; this program is expected to save consumers $2 million annually. The training program educates heating and cooling contractors on installation techniques to improve efficiency; this program is expected to benefit about 1,500 consumers and produce $170,000 in energy savings per year. A settlement in 2000 with Baltimore Gas & Electric and Allegheny provided for a surcharge of up to 1 mill per kilowatt hour to fund programs serving customers of those utilities, but the surcharge and related programs have not been implemented.

To encourage the development of additional programs, Senate Bill 654 of 2003 would have established an Energy-saving Investment Program administered by the administration. Residential customers would have had to contribute to a fund through a surcharge that each electric and gas company would have had to collect. The House Economic Matters Committee voted unfavorably on the bill. Like Maryland, 17 states have electricity restructuring laws; however, all but Maryland and Virginia have developed a public benefits fund similar to that proposed in the bill. Surcharges in the other states vary from .03 to 3 mills per kilowatt hour.

Regulation of Total Electricity Rates

The electricity restructuring law and implementing settlement agreements capped rates for periods of time that depended on the utility. With residential price caps about to expire in two service territories (PEPCO and Delmarva), legislation was introduced last session to soften anticipated price spikes. Senate Bill 739/House Bill 1056 of 2004 would have prohibited the commission, in any year in which a utility is required to provide SOS, from approving rate increases that exceeds the previous year's total rate by 10 percent. Utilities would have been able to recoup the difference between the requested rate increase and the 10 percent cap over a period not to exceed four years. The Senate bill was withdrawn, and the House bill was voted unfavorably by the House Economic Matters Committee.

Weatherization Component of the Electric Universal Service Program

The Electric Universal Service Program (EUSP) established under the electricity restructuring law consists of three components: bill assistance, arrears payments, and weatherization. The Office of Home Energy Programs (OHEP) in the Department of Human Resources administers EUSP which is funded by all ratepayers, at a level of $34 million each year. Since the program's inception, OHEP has been unsuccessful in developing an adequate plan dealing with the weatherization component. During last session, the question arose as to whether it would be more efficient for the State to have DHCD, which administers its own weatherization program, handle all weatherization rather than have two similar but inconsistent smaller programs in the Department of Human Resources and DHCD. Accordingly, the Budget Reconciliation and Financing Act of 2004 (Chapter 430) requires the agencies, as well as the commission, to prepare a report detailing the most appropriate method of merging the two programs, including statutory changes to accomplish the task. The report will be heard by the Joint Electric Universal Service Program Workgroup in mid-November.

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Business Regulation

Workers' Compensation

There has been a decline in the frequency of workers' compensation claims; however, medical costs continue to rise. Maryland ranks twelfth lowest in workers' compensation premium rates in 2004, an improvement over last year when Maryland was sixteenth lowest. During late fall, the Workers' Compensation Benefit and Insurance Oversight Committee anticipates discussing the recent revision to the medical fee guide and reviewing medical and pharmaceutical cost containment options to deal with the rising cost of workers' compensation insurance.

The Rising Cost of Workers' Compensation Insurance

According to an annual review of manufacturing industry costs by Actuarial and Technical Solutions, Inc., Maryland had the twelfth lowest workers' compensation premium rates in 2004. Despite the improvement over 2003 when Maryland was sixteenth lowest, Maryland has seen its ranking steadily deteriorate from the fifth lowest in 1998. Several states that have remained among the lowest premium states are Arizona, Indiana, Utah, Oregon, and Virginia.

The National Council on Compensation Insurance, Inc. (NCCI), an independent national rating organization, calculates the component of insurance premium rates that are needed to prefund projected claim loss payments to injured workers. Each year NCCI adjusts, subject to the approval of the Maryland Insurance Administration, the aggregate pure premium rates for Maryland. Based on data from policy years 2001 and 2002, NCCI's 2005 filing is an increase of 3.4 percent in overall loss costs. NCCI observes that there has been an overall decline in the frequency of claims; however, medical costs continue to rise. Prior year filings included the following overall adjustments: decrease of 6.1 percent for 2004 and increases of 1.6, 1.3, and 7.6 percent for 2003, 2002, and 2001, respectively.

A 2003 study by Milliman USA, an independent insurance consulting firm, identifies factors that may contribute to the rising costs of workers' compensation claims. The firm examined the claim experience of the Injured Workers' Insurance Fund (IWIF), the third-party administrator of the State's workers' compensation insurance and the insurer of last resort for workers' compensation coverage, and compared it to data analyzed by the Workers' Compensation Research Institute from 12 large workers' compensation states. IWIF's claims experience has relevance to the general experience of workers' compensation insurance claims in Maryland because it serves about 35 percent of the Maryland market. Significant cost drivers identified included the rate of attorney representation in the determination of permanent partial disability claims and the increased cost of medical payments.

A 2004 study by the National Academy of Social Insurance shows that, based on 2002 nationwide data, employers' costs and benefits to injured workers grew faster than workers' wages. An increase of 0.4 percent in workers' wages was the slowest growth in more than a decade, largely the result of a poor economy. Benefits rose by 7.4 percent, with employer costs up 13 percent. Generally, medical payments account for about 40 percent of the total benefits.

A 2004 study by the Council of State Governments concludes that the number of nationwide workers' compensation claims has been declining; however, workers' compensation costs and benefits paid out are still rising. A variety of factors cause high costs, including medical expense increases, investment income losses, effects of terrorist acts, slow economic growth, increasing fraud, extensive litigation, and workforce demographics.

Identifying Options to Control Cost Drivers

Since a wide range of factors influence workers' compensation systems, states have been considering an assortment of actions to contain medical costs and deal with inefficiencies. The Department of Legislative Services anticipates providing its study of recent state reforms in December 2004. Some options that have been identified by other states for controlling cost drivers are described below.

- To contain medical care costs, California requires medical treatment to be provided by networks established by employers or providers. To contain prescription drug costs, Arizona requires a prescription drug fee schedule that mandates the use of a generic equivalent drug unless the medical practitioner specifically requires a brand name drug. (According to NCCI, workers' compensation insurers in Maryland paid 75 percent more in 2001 than group health insurers for the same drugs.)

- To reduce the amount of lawyer involvement, Maine and Texas require parties to participate in a benefit review conference to attempt to resolve a dispute. (According to NCCI, attorney involvement in Maryland, as a percentage of claims, is higher than in neighboring states.)

- To limit the payment of temporary disability benefits, California caps these benefits at 104 weeks or 240 weeks for more serious injuries. To make the determination of permanent partial disability impairment ratings more objective, Tennessee uses a formula that lowers the benefit to an injured worker if the employer returns the worker to the worker's prior job at the same or greater wage.

Further, the Workers' Compensation Commission recently established a workgroup of representatives of the disciplines of the workers' compensation system to review inefficiencies in the State's workers' compensation system; the workgroup anticipates reporting its recommendations in December 2004.

Workers' Compensation Benefit and Insurance Oversight Committee

During late fall of 2004, the oversight committee will be discussing the following issues:

- Medical fee guide revision: The commission recently revised the medical fee guide to set reimbursements to medical providers based on 109 percent of the Medicare reimbursement amount for that service. Orthopedic groups were particularly dissatisfied since their reimbursements significantly decreased based on this new formula. An access-to-care issue may arise as these groups threaten to not participate in workers' compensation. (Prior calculations were based on prevailing charges of medical services; these have been unchanged for years, except for a 4 percent increase a few years ago.)

- Medical and pharmaceutical cost containment options: Insurers and claimant representatives will provide suggestions for dealing with rising costs.

- Workers' compensation fraud: Chapter 471 of 2004 requires the commission to refer to the Insurance Fraud Division any case in which a preponderance of the evidence establishes that a person knowingly affected the payment of compensation, fees, or expenses by means of a fraudulent representation. By December 31, 2004, the commission is required, in consultation with the Maryland Insurance Administration, to study how to prevent, identify, and deter workers' compensation fraud.

Reintroduction of Prior Legislation

In response to a June 2003 decision by the Maryland Court of Appeals (*Vernell Harris v. Board of Education of Howard County*, CA No. 43, Sept. Term 2002), the 2003 General Assembly considered several bills that would have altered the definition of an accidental personal injury. Current law defines a compensable accidental personal injury as an injury that arises out of and in the course of employment. While case law dating to 1927 has generally supported an "unusual activity" standard, the decision found no statutory basis for that standard to apply in order for an injury to be compensable, causing Maryland to be aligned more closely with 46 other states. Senate Bill 113/House Bill 13, Senate Bill 468, House Bill 749, and Senate Bill 638/House Bill 1069 (all failed) would have reversed the decision and preserved the unusual activity standard.

Although NCCI included a 2 percent increase in its 2004 filing, little post-*Harris* data is included in the experience period that is the basis of its 2005 rate filing. Critics of the ruling warn that the impact could be higher, causing premium rates to increase by at least 5 percent. The *2004 Joint Chairmen's Report* charged the commission with studying the effect of the decision. Since the commission's August 13, 2004, report concludes that it is too early to definitively confirm its impact, the commission intends to provide a follow-up report. While its actual impact remains to be seen, it is anticipated that legislation will be reintroduced to negate the decision by clarifying the application of an “unusual” test.

Business Regulation

Job Training Programs

Given that Maryland has numerous job training programs throughout State government, there is a need to eliminate redundancies and overlap. With an emphasis on strategic planning and policy setting for workforce development, the Governor's Workforce Investment Board was transferred in 2003 to the Department of Labor, Licensing, and Regulation. Despite the *2003 Joint Chairmen's Report* mandate for the investigation of possible sources of efficiency savings, the department has not issued a report on the restructuring of the job training programs.

Background

Maryland has numerous job training programs throughout the State which are administered by State agencies, as well as local governments. These programs target a variety of different populations, including welfare recipients, students, dislocated workers, ex-offenders, unemployed workers, higher education graduates, and individuals who are currently employed. For 10 years, there has been discussion concerning how the State should coordinate its multiple job training programs so that they are best utilized and made customer friendly and cost efficient.

During 2003 a significant change in this direction was made. The Governor's Workforce Investment Board (GWIB), functioning at the time as an independent agency, was transferred into the Department of Labor, Licensing, and Regulation (DLLR). Further, the General Assembly in its *2003 Joint Chairmen's Report*, mandated that GWIB investigate possible sources of efficiency savings in the delivery of the State's own workforce development system. The report specified that, in the current State budget climate, as resources become more limited, redundancy across agencies in the State's use of personnel and other resources should be eliminated.

In response to the report, DLLR found that the number of job training programs has caused redundancy, inefficiencies, and confusion to the citizens and is a problem with which the department needs to deal. The department briefly discussed the reorganization of the Division of Employment and Training into two entities to help with service delivery and fund management; however, the department has not issued a comprehensive report on the restructuring of the job training programs.

Governor's Workforce Investment Board

GWIB was established in 1983 as the Governor's Employment and Training Council. Years later this independent agency was transferred to the Department of Economic and Employment Development. In 1993 it was made an independent agency, assumed the duties of the State Council on Vocational-Technical Education, and began serving as Maryland's human resource investment council under the federal Job Training Partnership Act, which is now known as the federal Workforce Investment Act. Federal law mandates the existence of a GWIB-type organization to implement provisions of federal worker training programs. A 1998 executive order renamed the entity as the Governor's Workforce Investment Board. In 2003, the independent agency was transferred into DLLR, which is responsible for the day-to-day operations of the State's workforce development system.

GWIB develops plans, policies, and programs to maximize the potential of Maryland's workforce investment system for citizens and businesses. It oversees policies affecting education and training, advises the Governor on workforce needs, and recommends ways to meet those needs. Additionally, the agency works as a partner with State agencies, local governments, and the private sector to fully utilize State and federal funds and avoid duplication of effort.

The most significant change for GWIB since its transfer to DLLR has been the emphasis placed on strategic planning and policy setting for workforce development. While functioning as an independent agency, GWIB was more involved in operational oversight of job training programs, a task that has been absorbed by other entities, such as the local workforce investment boards. GWIB is now more involved in forecasting workforce needs and identifying emerging industries.

GWIB uses the "cluster" process to monitor and forecast workforce needs. Its 43 board members, which include State, local, and industry officials and private-sector representatives, are divided into industry cluster groups (groups of interrelated industries, including both primary and supporting businesses) with each group monitoring developments in their assigned industry and making recommendations based upon their expertise and the available data if the group is experiencing a skilled workforce shortage. There are industry cluster groups for healthcare, aerospace, hospitality and tourism, manufacturing, construction, and interactive technology. GWIB reports that it is attempting to monitor the broad range of jobs in the market, rather than emphasizing only technology-based jobs or those that require college education.

Redundancy or a Tangled Web

A large number of job training programs that have similar or identical missions, particularly in DLLR. Statewide, job training programs involve 7 cabinet level agencies and 31 separate job training programs. There are 12 programs for those with low-income workers, 8 for students, and 4 for dislocated workers. **Exhibit 1** lists the seven cabinet level agencies with worker training programs and a sample of their training programs. While not comprehensive, the list shows an indication of how diverse worker training is in Maryland. Other program providers include community colleges, public colleges and universities, and community-based organizations.

Exhibit 1
Selected State Worker Training Programs
2004

Maryland Agency	Program
Department of Aging	Senior Community Service Program
Department of Business and Economic Development	Maryland Industrial Training Program Partnership for Workforce Quality
Department of Education	Career and Technology Education Adult Education and Literacy Services Correctional Education Division of Rehabilitation Services
Higher Education Commission	Community Colleges Public Colleges and Universities
Department of Housing and Community Development	Community Services Block Grant Community Development Block Grant
Department of Human Resources	Family Investment Program Food Stamp Employment and Training
Department of Labor, Licensing, and Regulation	Workforce Investment Act Apprenticeship and Training Program Veterans' Services Maryland Business Works

Source: Governor's Workforce Investment Board

DLLR has reported that it wants to consolidate its programs and eliminate redundancies and overlap among programs. In this regard, some of its programs are now housed in the same building, allowing for a "one-stop" center for the public.

With worker training programs existing in several State agencies, as well as in various local governments, getting all of these groups together has always been problematic. The Governor's solution has been to transfer GWIB into DLLR. The new GWIB has begun taking on a more strategic planning role of the State's workforce development system. However, other than a new location and an emphasis on strategic planning, the basic functions of GWIB remain unchanged at this time.

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Business Regulation

Direct Shipments of Wine Across State Lines

In Maryland, alcoholic beverages may not be directly shipped to a consumer by either in- or out-of state manufacturers. The U.S. Supreme Court may rule in the next few months on whether, as allowed in New York and Michigan, it is a violation of the Commerce Clause for a state to permit in-state wineries to directly ship alcohol to consumers but restrict the ability of out-of-state wineries to do so. Depending on the ruling, legislation may be introduced during the 2005 session to permit direct shipment of alcohol to in-state residents by Maryland wineries.

Background

Since the Twenty-first Amendment repealed prohibition, states have had the primary role of regulating the sales of alcoholic beverages. Like many states, Maryland has established a three-tiered system governing these sales. A manufacturer must forward its product to a licensed wholesaler, who in turn must deliver the product to a licensed retail dealer for sale to consumers. This system facilitates tax collection and ensures that consumers may only buy alcoholic beverages from licensed in-state entities that are directly accountable to the State. Maryland does not allow the direct shipment of alcoholic beverages to a consumer in Maryland by either in-state or out-of-state manufacturers.

Starting in the late 1990s, the amount of mail order sales, by phone or over the Internet, of alcoholic beverages to consumers began to significantly grow throughout the country. In 2002, legislation was enacted in Maryland establishing the direct wine seller's permit. The Comptroller may issue the permit to an out-of-state wine manufacturer, brand owner, importer, or a Maryland agent of the brand owner or importer that holds an alcoholic beverages license or permit from another state or the federal government. A permit holder may sell wine to a consumer in Maryland by phone or over the Internet, as long as the brand of wine has not been distributed in Maryland within the previous two years. However, the permit holder must ship an order of wine to a licensed wholesaler, who must forward the order to a licensed retail dealer for delivery to the consumer.

Concerns about the Direct Shipment of Alcohol

In Maryland, several concerns have been raised regarding the direct shipment of alcoholic beverages. First, alcohol that is shipped directly to consumers does not pass through the State's three-tier system, resulting in a loss of sales and excise tax revenue. Second, direct shipment of alcohol to consumers could allow minors uncontrolled access to alcoholic beverages. This concern arises because most suppliers that ship directly to consumers do so by using a common carrier such as UPS, which is not obligated to check the age of the receiving party.

Many consumers, however, have expressed the desire to have the opportunity to obtain hard-to-locate alcoholic beverages, most often wines that are not distributed by wholesalers in the State. It is the wine industry that is most affected by the ability or inability to ship directly to consumers. In addition, many Maryland wineries have expressed interest in accessing markets outside of the State by shipping directly to consumers.

According to the Wine Institute, 13 states have “reciprocal” shipping laws in place, meaning that wineries can ship to consumers who live in those states as long as the wineries’ home state also allows out-of-state companies to ship to its residents. A bill to allow Maryland wineries to benefit from reciprocal shipping has not been introduced in the General Assembly. At least 15 additional states allow importation of limited quantities of wine for personal use, though the definition of “limited quantity” varies among the states.

Federal Constitutional Issues

Article I, Section 8, Clause 3 of the U.S. Constitution (the Commerce Clause) grants Congress the power to regulate commerce among the states. The Commerce Clause has been interpreted not only as a grant of regulatory authority, but as prohibiting the states from enacting laws that discriminate against interstate commerce (known as the “dormant Commerce Clause”). The Twenty-first Amendment to the U.S. Constitution, however, grants to the states broad power to regulate the importation of alcoholic beverages.

On December 7, 2004, the U.S. Supreme Court will hear arguments addressing this apparent conflict in the companion cases *Granhold v. Heald* and *Swedenburg v. Kelly*. In the former case, New York’s alcoholic beverage control law prohibits direct sales and shipments of wines to New York consumers from out-of-state wineries but permits direct sales and shipments to New York consumers by licensed in-state wineries. The latter case is similar, except that it involves Michigan’s alcoholic beverage law. In both states, out-of-state wineries are able to ship to the states’ consumers, but not directly; that is, they must go through the states’ three-tiered system.

The question presented to the court in these cases is: “Does a State’s regulatory scheme that permits in-state wineries directly to ship alcohol to consumers but restricts the ability of out-of-state wineries to do so [violate] the dormant Commerce Clause in light of Sec. 2 of the 21st Amendment?”

Business Regulation

Statewide Living Wage

Legislation establishing a statewide living wage passed in the 2004 session; however, the bill was vetoed by the Governor. The bill would have established a living wage for public contracts valued over $100,000, as well as a penalty structure for violation of the wage provisions.

Living Wage Laws

Living wage laws have three common features, some of which have been in place for over a decade. Living wage laws (1) require employers to pay wages that are above federal or state minimum wage levels, (2) are typically linked to definitions of family poverty, and (3) are not intended to cover every worker in a local economy. Some local ordinances also have provisions related to employee benefits such as health insurance and paid vacation. Those usually covered include workers employed by businesses that have a contract with the city or county government or receive economic development subsidies from the local jurisdiction. Living wage laws are currently in force in 105 localities and counties in the United States. There are currently no statewide living wage laws. Wage levels without health benefits range from $6.25 in Milwaukee, Wisconsin to $13.20 in Sonoma, California.

In Maryland, Baltimore City and Montgomery and Prince George's counties have passed living wage laws. In Baltimore City, Ordinance 442 requires the payment of a living wage set by the Board of Estimates. The hourly wage rate in effect for fiscal 2005 is $8.85. The board revises the living wage level annually. Montgomery and Prince George's counties each have living wage rates set at $10.50.

2004 Vetoed Legislation

Legislation to establish a statewide living wage passed both houses and was subsequently vetoed by the Governor. Senate Bill 621 would have proposed a statewide living wage for State contracts, consisting of two main provisions.

Living wage of $10.50/hour for State contracts valued over $100,000

- The wage rate would have been tied to changes in the consumer price index for the Washington, DC and Baltimore metro areas.

- The bill would not have applied to employees under 18 years of age or employees who work less than 13 consecutive weeks on a contract, conflicts with contracts under federal wage requirements, or contracts subject to higher wage requirements (prevailing wage).

- The bill also would not have applied to State contracts for services needed immediately to prevent or respond to an imminent threat to public health or safety, with a public service company, with a nonprofit entity, between units of State government, or between a unit and a county or Baltimore City.

Rights of restitution for employees and penalty provisions against employers

- The Department of Budget and Management would have been required to investigate complaints for all units of State government.
- Employees would have been able to sue for damages for an employer's failure to pay the living wage.
- In addition to restitutionary damages to employees, the bill would have called for a $20/day per violation payable by the employer to the State.
- The bill would have required employers to post the living wage in English, Spanish, and any other language commonly used at the job site. There would have been a $50 penalty per violation.

The General Assembly has the opportunity to override the veto at the opening of the 2005 legislative session.

Living Wage Arguments

The living wage initiative is marked by two central arguments. First, higher wages lead to a better quality of life for workers. Second, living wages increase costs to the State and some contractors.

Proponents argue that the living wage for State contracts will increase worker quality of life. Higher wages for employees could lead to increased worker productivity and satisfaction, which may lower turnover. Lower turnover means less time training employees and may possibly lower contract costs for the contractor. Raising a worker's income also enables the worker's family to attend to other health and educational needs. Further, Temporary Assistance for Needy Families and other public assistance payments are income-based, and an increase in wages may make families ineligible for these benefits. This has the effect of lowering State welfare costs.

Opponents argue that imposing a living wage requirement on public contracts would increase the cost of those contracts to the State. Contractors with increased wages may raise their bids to the State. Further, many contractors may not bid on a contract with living wage requirements as they would be forced to pay workers on public contracts more than their workers on private contracts. Decreased participation by contractors may mean that the bid process is inherently less competitive and may drive contract costs higher than the increased wage factor.

Opponents also argue that higher wage costs may discourage small businesses from bidding on these contracts.

Public Safety

Assault Weapons

The 1994 federal assault weapons ban expired in September 2004, thus reauthorizing the manufacture, transfer, and possession of certain specific semiautomatic assault weapons. Most of the weapons that were subject to the federal ban are authorized as “regulated firearms” in Maryland, and may now once again be sold or possessed in the State. Based on the expiration of the federal ban, recent legislative attempts to prohibit the sale and possession of assault weapons in Maryland are likely to be reintroduced in the 2005 legislative session.

Expiration of the 1994 Federal Assault Weapons Ban

A federal assault weapons ban was enacted in 1994 (Title XI of the Federal Violent Crime Control and Law Enforcement Act of 1994) that prohibited the manufacture, transfer, or possession of specific models of semiautomatic assault weapons or their copies, as well as assault weapons that have a combination of certain military characteristics (such as large capacity ammunition magazines, flash suppressors, pistol grips on a rifle or shotgun, and barrel shrouds to cool gun barrels during multiround firings). Lawful possession and transfers prior to the law’s enactment date of September 13, 1994, were still authorized.

The federal ban also restricted the manufacture and sale of ammunition magazines capable of holding more than 10 rounds. Prior to the law, many firearms were sold standard with 30 round magazines. The law exempted assault weapons and large capacity magazines that were manufactured prior to the law’s enactment date.

The federal ban terminated on September 13, 2004, meaning that the 19 specific semiautomatic assault weapons previously prohibited under the federal ban may now be lawfully manufactured and possessed. Most of the weapons previously prohibited under federal law are listed as “regulated firearms” under Maryland law. Although under Maryland’s statute those weapons can be transferred and possessed subject to certain conditions, the effect of the 1994 federal ban was to prohibit their sale and possession in Maryland. With the federal ban lifted, these specific weapons may once again be lawfully transferred and possessed as regulated firearms in Maryland.

Maryland Assault Weapon Laws

The State regulates the possession and sale of assault weapons in the same manner as the possession and sale of handguns, both of which are defined together as regulated firearms. “Assault weapons” are defined as a list of 45 specific semiautomatic weapons and their copies (mostly types of semiautomatic rifles and shotguns, including most of the list of 19 specific weapons that were subject to the former federal ban). Before a person purchases, rents, or transfers a regulated firearm in the State, the person must submit to the State Police or other designated law enforcement agency a firearm application that identifies the applicant and the firearm that is the subject of the transaction. Applications are investigated by the State Police and are subject to a seven-day waiting period before the transaction may take place.

An applicant must be at least 21 years old; have never been convicted of a felony, crime of violence, or misdemeanor that carries a penalty of more than two years imprisonment; and must not be addicted to drugs or alcohol or have a history of mental disorder. An applicant is required to complete a certified firearms safety course through the Police Training Commission. An application may be denied by the Secretary of State Police if the Secretary determines that the application contained false information or was not properly completed, or if the Secretary receives notice from a physician that the applicant suffers from a mental disorder and is a danger to the applicant or others.

Proposed State Assault Weapons Ban

Introduced partially in response to the Washington area sniper attacks in the fall of 2002 in which the alleged gunmen reportedly used an assault weapon, Senate Bill 494 and House Bill 844 of 2003 would have, among other provisions, prohibited the possession, sale, transfer, or transportation of assault weapons in the State.

In 2004 Senate Bill 288 and House Bill 1298 would have designated 45 specified firearms as “assault weapons” and, with certain exceptions, prohibited a person from transporting an assault weapon into the State or possessing, selling, offering to sell, transferring, purchasing, or receiving an assault weapon. The bills also would have created a new crime by specifically prohibiting a person from using an assault long gun or copycat weapon in the commission of a felony or crime of violence, and would have required the Handgun Roster Board to compile, maintain, and publish a roster of prohibited assault weapons and send copies of the roster to all licensed firearms dealers.

The 2003 and 2004 bills failed, but similar legislation is likely to be reintroduced during the 2005 session, particularly in light of the expiration of the federal assault weapons ban.

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Public Safety

Project RESTART

As the Department of Public Safety and Correctional Services plans to begin implementation of its offender rehabilitation initiative, Project RESTART, at two State correctional facilities, potential budgetary and programmatic issues remain and will require continued legislative review and monitoring.

Background

In November 2003, the Department of Public Safety and Correctional Services (DPSCS) announced a philosophical shift in its correctional function that focuses not only on inmate control and confinement, but also on rehabilitation through an initiative entitled Re-entry Enforcement Services Targeting Addiction, Rehabilitation, and Treatment (RESTART). Project RESTART is intended to enhance and expand existing substance abuse treatment, job skills training, cognitive restructuring, and reentry counseling services. The department anticipates the implementation of RESTART pilot programs at two sites in January 2005.

The rationale behind Project RESTART is that by assisting offenders in addressing addiction problems, encouraging positive behavior modification, and teaching skills for successful reentry into the community, a reduction in postincarceration criminal activity and recidivism rates can be achieved, which could potentially save the State money on incarceration costs in the long term.

The department plans to launch the pilot programs at the Maryland Correctional Training Center in Hagerstown and the Maryland Correctional Institution for Women in Jessup. Up to 50 correctional officer positions will be converted into program personnel positions to aid the RESTART effort. In addition to funds used in the correctional officer conversion, the Senate Budget and Taxation Committee and the House Committee on Appropriations released $1.2 million in general funds for the program start-up. The department may also use up to $500,000 of existing resources to support the pilot programs.

Potential Issues

Despite the laudable goals of Project RESTART, there remain a number of unresolved issues regarding the ability of the department to successfully implement the program and to realize the anticipated outcomes. These issues include:

- **Costs –** In July 2004, DPSCS indicated that it could rollout the program departmentwide within the original $9.2 million budget estimate over a three-year period. However, the costs of implementing RESTART at the two pilot sites are currently estimated at $3.1 million.

- **Tracking Recidivism Rates –** There is continued cause for concern about DPSCS' plan to track recidivism rates of program participants manually. The department plans to use its existing Repeat Incarceration Supervision Cycle report and a rudimentary database until a new management system can be developed. However, since the department has a history of difficulty in providing electronic data free from human error, it is questionable whether it will be able to produce reliable data from which the legislature may evaluate RESTART's outcomes.

- **Program Evaluation Timeline –** DPSCS plans to implement the RESTART program at the pilot sites in fiscal 2005. However, data about participant recidivism rates will not be available until 2009. Without an accurate assessment of the pilot site outcomes, systemwide implementation may waste scarce State resources.

- **Program Effectiveness –** DLS has previously questioned the department's ability to implement RESTART in a way that ensures the greatest chance of success. While the studies on which DPSCS relies do demonstrate that the tactics being offered (cognitive restructuring, education, job training, reentry counseling) can be effective, the studies do not appear to differentiate between cause and effect: did the program convince an offender not to commit additional crimes, or did the offender who decided not to commit additional crimes join the program? Furthermore, factors that influence success (professional facilitators, dedicated space, leadership) may not be present in Maryland's version.

Criminal Law

Death Penalty Update

From a moratorium on the death penalty to a State execution and another pending death warrant, Maryland has been wrestling with the death penalty issue in recent years. Recent federal cases have examined death penalty eligibility, while pending State challenges are alleging racial bias in the imposition of death sentences.

Background

The use of capital punishment continues to be a controversial political and social issue throughout the country. Maryland has grappled with several death penalty issues in recent years, including a gubernatorial moratorium in 2002; a University of Maryland study of the effects of race and jurisdiction in pursuing death penalty eligible cases in the State; the lethal injection execution of a Maryland death row inmate, Steven Oken, this past June; and the issuance of another death warrant this past October.

Several court challenges to the constitutionality of Maryland's death penalty statute have been attempted in recent years, but in each instance the statutory procedures have been upheld. Last year one Maryland death sentence was overturned by the U. S. Supreme Court based on a finding of ineffective assistance of counsel. Additional State and federal court challenges to the death penalty are pending and legislative proposals to both expand the scope and restrict the implementation of Maryland's death penalty statute have been attempted in recent years and are likely to continue in the 2005 session.

Recent Supreme Court Cases

The Supreme Court has recently waded back into the death penalty debate with recent cases involving death penalty eligibility for the mentally retarded and minors. Although Maryland's death penalty statute specifically prohibits death sentences for the mentally retarded or minors, the fact that the court is actively addressing eligibility criteria may raise some issues for additional challenges in the State.

In *Atkins v. Virginia*, No. 00-8452 (2002), the Supreme Court held that executions of mentally retarded criminals are "cruel and unusual punishments" prohibited by the Eighth Amendment. The court found that a growing number of states were passing laws barring the execution of the mentally retarded and added that while mentally retarded individuals frequently know the difference between right and wrong and are competent to stand trial, their mental deficiencies reduce their level of blameworthiness. Juvenile death-penalty opponents saw promise in the *Atkins* case to try to find a similar argument as applied to minors. If mental retardation made certain defendants less blameworthy and thus ineligible for the death penalty, the same reasoning may be applicable to minors.

On October 13, 2004, the Supreme Court heard oral arguments in the case of *Roper v. Simmons*, on whether the execution of a person under the age of 18 years violates the Eighth Amendment ban on cruel and unusual punishment. The question arises because of a Missouri case in which 17-year old Christopher Simmons was sentenced to death for a murder-robbery.

The Supreme Court ruled in 1989 that the minimum permissible age for the imposition of the death penalty was 16, but there has been a recent movement opposing the imposition of the death penalty for any juvenile. Opponents argue that brain research indicates the adolescent brain is not developed enough to inhibit impulsive behavior. As in *Atkins*, the legal argument in *Roper v. Simmons* centers around the evolving sensibilities in society as to the appropriateness of executing adolescents as evidenced by the large number of states and countries that prohibit the execution of juveniles.

Recent State Challenges

Three death penalty appeals are currently pending in Maryland, all basing their arguments primarily on the issue of racial bias in the imposition of the death penalty. John Booth, who was convicted and sentenced to death in 1984, has filed an appeal in the Baltimore City Circuit Court. Booth’s appeal is scheduled to be heard in the summer of 2005. Wesley Eugene Baker was convicted and sentenced to death in Harford County in 1992. Baker filed an appeal in October 2004. Finally, a death warrant was signed for Heath W. Burch by a Prince George’s County judge in October 2004. Burch, who was convicted and sentenced in 1996, is scheduled for lethal injection the week of December 6, 2004. The judge who signed the death warrant also granted a stay of execution and gave Burch 30 days to file an appeal. Burch’s lawyers have indicated that the basis of the appeal will be racial bias.

All three of these defendants are basing their appeals on the 2002 University of Maryland study examining the influence of race (both victim’s and offender’s) and geography (where the crime occurred and was prosecuted) on the imposition of the death penalty. In particular, the three defendants are focusing on the issue of racial bias examined in the study.

The study concluded that there appeared to be disparities in the imposition of the death penalty based on the race of the victim. The study found that by itself, the race of the offender did not play a clear role in the processing of death penalty cases at any of the stages of prosecution. However, the study did find evidence of disparity when the race of the victim is considered. If a victim is white, the defendant is significantly more likely to receive a notice of intent to seek the death penalty; however, the study found that when the case actually reaches the penalty phase, the race of the victim does not significantly impact on the imposition of the death penalty.

Additionally, the study found that the race of the offender and the victim when viewed together has an impact on the imposition of the death penalty. If an African American offender kills a white victim, he/she is substantially more likely to be charged with a capital offense and, therefore, is at a greater risk of a facing a death sentence. In all three of the cases pending appeal the defendant is African American and the victim was white.

Legislation

Several bills were introduced in the 2004 session related to the death penalty, none of which passed. Most would have added to the list of aggravating factors that make an individual eligible for the death penalty. The additions included the commission of more than one murder in the first degree, murder in retaliation for testimony, murder of an off-duty law enforcement officer, murder of victims and witnesses, and murder of a person under a protective order. Additionally, there was once again a bill to repeal the death penalty in the State.

Given the attention that will be drawn to the findings of the University of Maryland study by the most recent appeals in Maryland's death penalty cases, it appears likely that additional legislative proposals will be introduced in the 2005 session.

Criminal Law

Recent U. S. Supreme Court Decisions – Effect on Maryland's Criminal Law

From a moratorium on the death penalty to a State execution and another pending death warrant, Maryland has been wrestling with the death penalty issue in recent years. Recent federal cases have examined death penalty eligibility, while pending State challenges are alleging racial bias in the imposition of death sentences.

Background

During the first half of 2004, the U. S. Supreme Court decided two landmark Sixth Amendment cases (right to trial by jury and right to confront witnesses) arising out of the State of Washington that were widely reported in the media and could have far-reaching implications for criminal law and procedure throughout the nation. Maryland's law does not appear to be as negatively impacted by these decisions as many other states, but the court's rulings in these cases may still require a legislative response in order to maintain the constitutionality of certain provisions of Maryland's criminal code.

Right to Trial by Jury – *Blakely v. Washington*

In June 2004, the Supreme Court held in *Blakely v. Washington*, No. 02-1632 (2004), that a sentencing judge's imposition of an enhanced penalty, based on facts that were not admitted by the defendant or found by a jury, violated the defendant's right to a trial by jury. Blakely pled guilty to the 1998 kidnapping of his estranged wife. The facts he admitted to in his plea supported a maximum sentence of 53 months of imprisonment. At his sentencing, the trial judge found that Blakely had acted with "deliberate cruelty," which is a statutorily enumerated ground for departure from the 53-month maximum sentence, and instead imposed a sentence of 90 months of imprisonment. Blakely then appealed, claiming that the sentencing enhancement by the trial judge violated his constitutional right to a trial by jury. In its holding, the court applied its earlier decision in *Apprendi v. New Jersey*, 530 U.S. 466 (2000), which generally requires that "other than the fact of a prior conviction, any fact that increases the penalty for a crime beyond the prescribed statutory maximum must be submitted to a jury, and proved beyond a reasonable doubt" *Id*. at 490. The court in *Blakely* held that under the *Apprendi* analysis, the finding of "deliberate cruelty" to support the enhanced 90-month penalty is a fact that must be determined by the jury beyond a reasonable doubt and not simply determined by a judge at the time the sentence is imposed following trial.

The immediate impact of this decision was to throw Washington State's (and at least 10 other states' and the federal government's) mandatory criminal sentencing statutes and procedures into question. Under mandatory sentencing procedures, a range of sentence is provided if certain facts are found by the jury or admitted to in a plea agreement. If a sentencing judge finds that additional facts or circumstances exist beyond what was found by the jury or admitted to by the defendant, another possible range of increased sentences is triggered.

Fortunately, Maryland has a largely indeterminate sentencing structure that features, in most instances, only a maximum statutory sentence. While Maryland does have a sentencing guideline system to try to provide greater uniformity of sentencing for offenses, it is a discretionary system rather than mandatory, and is usually not based on a finding of additional facts to determine the length of sentence.

However, Maryland does have a handful of statutory crimes that provide for enhanced penalties based on the existence of certain facts beyond the elements of the underlying crime. For example, driving while under the influence of alcohol ("DUI") carries a certain maximum penalty. The State must charge and prove beyond a reasonable doubt the statutory elements of the offense. In the sentencing provisions for a conviction of that statutory offense, the maximum penalty for the violation is listed. But in addition to the maximum penalty for DUI, a different, higher maximum penalty is established for a DUI when the driver is transporting a minor at the time of the violation. Under these current provisions, the fact of the transported minor might not be charged as a part of the underlying DUI offense and might not be found to exist beyond a reasonable doubt by the jury, but instead may be found by the judge at sentencing.

The remedy for this apparent defect under *Blakely* and *Apprendi* may be to repeal the factual penalty enhancement in the penalty provisions, and to place the factual circumstance that leads to the increased penalty into the factual elements of the underlying offense to be charged as its own, separate new offense. Legislation to correct these apparent constitutional defects within the half dozen or so criminal provisions affected is likely to be introduced during the 2005 session.

Confrontation Clause – *Crawford v. Washington*

In the spring of 2004, the Supreme Court also decided *Crawford v. Washington*, No. 02-9410 (2004), which held that, in most instances not involving certain hearsay exceptions, a testimonial statement by an unavailable witness is admissible in a criminal trial only if there is a prior opportunity to confront the witness through cross-examination. The court appeared to overrule part of its earlier decision in *Ohio v. Roberts*, 448 U.S. 56 (1980), which allowed the admissibility of statements of unavailable witnesses without the ability to cross-examine, if the judge determines that the statement involves either a hearsay exception or carries "particularized guarantees of trustworthiness" such as consistency with other statements, statements against penal interest, or even based on the level of detail or circumstances of the statement.

Legislation may be introduced in the 2005 session that would provide a mechanism to comply with the constitutional requirements outlined in *Crawford*, allowing a defendant to request the presence of a representative of a financial institution in order to object to the State's use of a dishonored check as presumptive evidence of the defendant's lack of an account or sufficient funds, or the defendant's intent to cause the drawee to dishonor a check, in order to prove the elements of a criminal violation of the bad check law.

Criminal Law

Victim and Witness Intimidation

The intimidation of witnesses, ranging from verbal threats to acts of physical violence or even murder of witnesses or their family members, is a growing problem in Maryland's criminal justice system. The murders of the Dawson family in Baltimore City in 2002 focused public attention and outrage on the perpetrators of these crimes. A number of bills seeking to provide greater protection against victim and witness intimidation, including two from the Administration, were considered during the 2004 legislative session and are likely to be reintroduced in 2005.

Background

Public attention and outrage became focused on the problem of victim and witness intimidation by the October 2002 firebombing of the Baltimore City home of Angela and Carnell Dawson, which killed Mr. and Mrs. Dawson and their five children, ranging in age from 9 to 14. The arson was widely viewed as retaliation against the Dawsons for complaining to police about drug dealing in their neighborhood. A number of other serious reports of witness intimidation have subsequently made the local news.

Prosecutors and others involved in the criminal justice system report that victim and witness intimidation is a growing problem in the State, particularly in larger jurisdictions such as Baltimore City and Prince George's County. The problem has become so pervasive that it is often described as a "culture of intimidation." Frequently, gang members are the suspected perpetrators. Examples of the intimidation range from verbal threats to acts of physical violence to the murder of witnesses or their family members. When witnesses fail to testify at trial, either because they are afraid or have been killed, serious criminal cases are dismissed from court or are not prosecuted. For example, in Baltimore City in 2003, approximately 75 shooting cases had to be dismissed due to victim/witness issues, the majority of which included some form of intimidation. Several homicide cases in the city were dismissed or pled down from first degree murder to a lesser charge due to witness intimidation. In addition, the Baltimore City State's Attorney's Office relocated approximately 95 witnesses on a permanent or temporary basis and assisted others in protection-related matters. Another significant effect of the problem is that many citizens are forced to live in fear because of threats or potential threats by those who commit crimes.

Current Law

Although certain acts of witness intimidation are currently prohibited by statute, prosecutors complain that the penalties for these crimes are not high enough and the prohibitions are not broad enough to be very helpful in punishing and deterring witness intimidation. Three different types of witness intimidation are prohibited by existing law: (1) witness intimidation that is intended to influence a witness to testify falsely or avoid a court summons; (2) retaliation against a witness for testifying or reporting a crime; and (3) influencing or impeding a juror, witness, or officer of the court in the performance of the person's official duties.

Section 9-302 of the Criminal Law Article prohibits a person from harming or threatening to harm another or damaging or destroying property with the intent to influence a victim or witness to testify falsely or to induce a victim or witness to avoid a summons to testify or be absent from an official proceeding. Section 9-303 of the Criminal Law Article prohibits a person from intentionally harming another, or damaging or destroying property with the intent of retaliating against a victim or witness for testifying against that person or reporting a crime. Both violations are misdemeanors punishable by up to five years' imprisonment. Section 9-305 of the Criminal Law Article prohibits a person from trying to influence, intimidate, or impede, by threat, force, or corrupt means, a juror, witness, or court officer in the performance of the person's official duties. A violation is a misdemeanor punishable by up to five years' imprisonment, a fine of $10,000, or both.

Legislative Initiatives

A number of bills were introduced during the 2004 session that attempted to provide prosecutors with additional tools to combat the problem of victim/witness intimidation. Senate Bill 185/House Bill 296, an Administration bill, would have added elements to the three current law intimidation prohibitions, including making the solicitation of acts of witness intimidation a violation of the law. The bill also would have altered the penalties for the crimes, including increasing the penalty for more serious violations to a felony with a maximum consecutive 20-year prison sentence, and removed cases of witness intimidation by a minor from the exclusive original jurisdiction of the juvenile court if the offense is committed by a child 16 or older. Additionally, the bill would have adopted the federal hearsay exception (rule of forfeiture by wrongdoing) for a statement offered against a party that has engaged or acquiesced in wrongdoing that was intended to and did procure the unavailability of a witness who was the declarant of the statement. Another Administration bill, Senate Bill 131/House Bill 301, would have expanded the list of aggravating circumstances that establish death penalty eligibility to include the commission of murder in the course of committing or attempting to commit a witness intimidation offense.

Both of these Administration bills were unsuccessful, as were other related witness protection bills dealing with the protection of the identity of victims and witnesses and the admissibility of videotaped statements by witnesses. However, similar bills are expected to be introduced during the 2005 session.

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Civil Proceedings

Medical Malpractice Tort Issues

A dramatic increase in the costs of medical malpractice liability, particularly malpractice insurance premiums, will spur proposals for tort reforms.

Medical Malpractice Insurance Crisis Overview

Increases in medical malpractice premiums and awards have drawn national attention and, according to the American Medical Association, have contributed to a "crisis" in 20 states. The current crisis is actually the third such crisis in the past 30 years. The first crisis was spurred by massive losses in the medical professional liability insurance market in the 1970s that forced many insurers out of the market. The second crisis occurred in the 1980s and was driven by rampant increases in the frequency and severity of paid claims. The current crisis appears to be a combination of many factors, including the rise in claim severity nationwide, the exodus from the market of several insurers, declining investment yields, and prior premium rates set low to garner market share.

Nationally, signs of a third crisis emerged in 2001 when the St. Paul Companies, the nation's largest medical professional liability carrier, ceased offering coverage to any physician in the country. Maryland appeared unaffected until June 2003, when the State's largest medical professional liability insurer, the Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), received approval from the Maryland Insurance Commissioner for a 28 percent rate increase in insurance premiums effective January 1, 2004.

In June 2004 Medical Mutual requested a rate increase of 41 percent. Among other factors, Medical Mutual pointed to an increase in claim severity as prompting the need for increased rates. In calendar 2002, Medical Mutual paid claims, including defense costs, totaling \$56.0 million compared to \$93.2 million in 2003. A 33 percent rate increase effective January 1, 2005, was approved and will increase the cost of medical professional liability insurance to approximately \$150,000 for obstetricians, the highest risk specialty.

Maryland's Response

Medical Mutual's rate increases prompted several unsuccessful proposals during the 2004 session and the creation of three different groups to study issues relating to medical malpractice. During the 2004 session, the Speaker convened a workgroup. During the 2004 interim, the President formed the Special Commission on Medical Malpractice Liability Insurance, and the Governor established the Governor's Task Force on Access to Health Care.

These groups considered several facets of the medical liability issue, including tort reform, patient safety, insurance reform, physicians' reimbursements, and liability insurance rate increases.

The most significant tort reform proposals considered include:

- reducing the current cap on noneconomic damages and eliminating or decreasing the $15,000 yearly escalator for the cap;
- eliminating the double cap on noneconomic damages that exists for some wrongful death actions and survival actions;
- requiring the use of periodic payments for awards and judgments;
- limiting attorney contingency fees and prohibiting or limiting the use of attorney referral fees;
- restricting how economic damages are calculated;
- abolishing or modifying of the collateral source rule; and
- increasing use of alternative dispute resolution, including mediation.

Nearly 40 percent of doctors in the State have threatened to quit their practices, reduce hours, move from the State, or retire in response to insurance rate increases. Drawing from the hearings held by the House, Senate, and Governor's workgroups, the General Assembly is working with the Governor to develop proposals that could include immediate relief for doctors as well as long-term reform options to promote stability in the medical professional liability insurance cycle. Such options include a temporary State reinsurance fund for insurers that would be subsidized through the imposition of fees on individuals whose license or privilege to drive has been cancelled or revoked, the repeal of the 2 percent premium tax exemption on health maintenance organizations, or a general fund appropriation in the State budget. Possible long-term reform options are still being considered but include changes to the court liability system, patient safety rules, and new insurance regulation.

For further discussion of nontort proposals to address the current medical malpractice issue, see the "Medical Malpractice Insurance Reform and Patient Safety" paper under the Health and Health Insurance section of this book.

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Civil Proceedings

Child Abuse and Neglect – Termination of Parental Rights

A significant revision of current law governing the termination of parental rights and adoptions that would simplify both substantive and procedural statutes and meet standards required to maintain federal funding related to the State's foster care program may be introduced at the request of the Maryland Judicial Conference.

Permanency for Families and Children

Since 2000 the Maryland Judicial Conference (MJC) has been involved in rewriting the statutes governing termination of parental rights (TPR) and adoptions. The Foster Care Court Improvement Project (FCCIP), a federal grant-based program within the Maryland Judiciary, was directed to complete this review under the purview of the Child in Need of Assistance (CINA) subcommittee of MJC. The CINA subcommittee consists of judges, masters, Department of Human Resources representatives, attorneys, staff from local departments of social services, and private adoption agency representatives.

The CINA subcommittee found that the existing TPR and adoption statutes combine different substantive areas and procedures, resulting in unnecessary complexity. The subcommittee also believes the revisions are necessary to improve the State's foster care program and comply with federal standards for the timely and permanent placement of children.

During the 2003 session, TPR legislation was introduced on behalf of MJC but was withdrawn at its request. During the 2004 session, Senate Bill 697/House Bill 882 were introduced, but each was given an unfavorable report. During the 2004 interim, the CINA subcommittee held meetings for interested parties to discuss how the TPR and adoption statutes should be revised. Further revisions were made and in the fall of 2004 a new draft of the legislation was presented to the House Judiciary Committee. However, the CINA subcommittee and FCCIP intend to make additional revisions before the legislation is introduced in the 2005 session.

The current draft legislation includes the following major changes:

- ***Organization:*** TPR and adoption statutes would be organized into three areas to clarify the legal distinctions between involuntary termination and voluntary relinquishment of parental rights: (1) Department of Social Services-related guardianship and adoption proceedings; (2) voluntary agency adoptions and guardianship proceedings; and (3) independent adoptions.

- ***Paternity:*** The definition of paternity would be expanded to include the results of genetic testing and would specify the responsibility for the payment of genetic testing. Any hearings on the issue of paternity would be required to be held before a ruling on a petition for guardianship.

- ***Internet Notification:*** The provisions for adequate notice to birth parents of the filing of a guardianship petition would specify the steps that must be taken to search for the parents and the appropriate language for a publication notice. Publication of the notice for 30 days on a Department of Human Resources-administered web site would be considered adequate notice, as an alternative to the current requirement of publication in a general circulation newspaper for one day.

- ***Revocation of Consent:*** A period of 30 days for a parent to revoke consent to guardianship or adoption would be established and the 30-day revocation period would run from the time the consent is filed in court, rather than from the time the parent first gives consent.

- ***Conditional Consent:*** A consent to guardianship that is conditional on placement with or adoption of the child into a specific family as long as the family is ultimately approved for adoptive placement would be authorized.

- ***Adoption Without TPR:*** A court would be authorized to enter an adoption order for a CINA without completion of a separate TPR proceeding in order to facilitate completion of adoptions where one parent consents to adoption and the other parent cannot be located, is deceased, or otherwise does not object.

- ***Post-adoption Contact:*** Written agreements between birth and adoptive parents that permit contact after adoption would be enforceable by a court. A court would be able to modify a written agreement and refer disputes to mediation. Parents would be able to have separate written agreements.

- ***Reasonable Efforts:*** A court would be required to determine and document whether the local department of social services made reasonable efforts to facilitate permanent placement, including a report on the suitability of a proposed guardianship placement from the department of social services in reviewing a permanency plan for a CINA before custody and guardianship are granted to an individual. Timely and permanent placement of CINAs would be established as a priority through continuing judicial oversight of CINAs after guardianship is awarded.

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Civil Proceedings

Same-sex Civil Unions and Marriages

The issuance of marriage licenses to same-sex couples in Massachusetts and a circuit court suit alleging that Maryland's prohibition on same-sex marriage violates State constitutional rights are likely to prompt proposal of a constitutional amendment to ban same-sex marriage and legislation to provide that Maryland does not recognize same-sex marriages performed in another jurisdiction. By contrast, gay rights advocates may propose legislation to (1) legalize same-sex marriage; (2) recognize "civil unions" akin to marriage for homosexual couples; or (3) extend to same-sex partners the rights and benefits of married couples.

Background

In 1993 the legal status of individuals of the same sex who entered into a familial relationship garnered national attention when the Hawaii Supreme Court ruled that a law denying same-sex couples the right to marry violated state constitutional rights. In 1998 voters in Hawaii adopted a constitutional amendment effectively overturning the decision by authorizing the legislature to reserve marriage to couples of the opposite sex.

In April 2000, Vermont became the first state to recognize "civil unions" that provide to same-sex partners virtually all the rights and benefits of married couples.

In November 2003, the Supreme Judicial Court of Massachusetts held that barring an individual from the protections, benefits, and obligations of civil marriage solely because that individual would marry a person of the same sex violates the Massachusetts Constitution. Subsequently, in February 2004, the court ruled that authorizing civil unions for same-sex couples while prohibiting them from marrying also was not constitutional. As a result, Massachusetts began issuing marriage licenses to same-sex couples in May 2004.

In July 2004, nine homosexual couples sued Maryland claiming that its law prohibiting marriage between individuals of the opposite sex violates State constitutional rights.

During the November 2004 elections, voters in 11 states approved constitutional amendments to define marriage as a union between a man and a woman.

Current Law

Under the Full Faith and Credit Clause of the U. S. Constitution, states are required to give full faith and credit to the public acts, records, and judicial proceedings of every other state. Therefore, Maryland generally will recognize foreign marriages that are validly entered into in another state. For example, Maryland will recognize a common law marriage from a foreign jurisdiction, although common law marriages are not valid in Maryland. *Henderson v. Henderson*, 199 Md. 449 (1952).

However, the Full Faith and Credit Clause does not require a state to apply another state's law in violation of its own legitimate public policy. See *Nevada v. Hall*, 440 U.S. 410 (1979). Similarly, the *Henderson* court stated that Maryland is not bound to give effect to marriage laws that are "repugnant to its own laws and policy." 199 Md. at 459. Since 1973, Maryland law has provided that only a marriage between a man and a woman is valid in this State. The Office of the Attorney General has advised that the Maryland law prohibiting same-sex marriage would create a valid public policy exception to the general rule that marriages valid where performed are valid anywhere.

In 1996 Congress passed the Defense of Marriage Act, which allows a state to deny recognition of a public act, record, or judicial proceeding of any other state respecting a relationship between persons of the same sex that is treated as a marriage under the laws of the other state.

Approximately 36 states (including Maryland) have passed laws that either prohibit same-sex marriages or deny recognition of same-sex marriages solemnized in another jurisdiction. An additional six states have adopted constitutional amendments defining marriage as a union between a man and a woman. During the November 2004 elections, constitutional amendments to ban same-sex marriage were on the ballot and passed in 10 of the states that already had statutory prohibitions against same-sex marriage and in one additional state.

Legislative Initiatives

Legislation relating to same-sex marriages is not new in Maryland. Proposals to ban recognition of lawful out-of-state marriages by same-sex couples (House Bill 1268 of 1996, House Bill 398 of 1997, Senate Bill 565 of 1998, House Bill 1128 of 1999, and House Bill 531 of 2001) were unsuccessful. During the 2004 session, the legislature considered Senate Bill 673/House Bill 16 (both failed), which would have proposed an amendment to the Maryland Constitution defining a valid marriage as a marriage between a man and a woman only. Additionally, Senate Bill 746/House Bill 728 (both failed) would have specified that a marriage between persons of the same sex that is valid in another state or foreign jurisdiction is not valid in Maryland.

Measures to legalize homosexual marriage were proposed in the 1998 session (House Bill 1259) and in the 2000 session (House Bill 919) but were unsuccessful.

Both a constitutional amendment to ban homosexual marriage and a bill to prohibit the recognition of same-sex marriages performed in another jurisdiction are likely to be reintroduced during the 2005 session. By contrast, advocates for gay rights may propose legislation to legalize same-sex marriage, to recognize "civil unions" akin to marriage for homosexual couples, or to extend to same-sex partners the same benefits and rights of married couples.

Civil Proceedings

Child Support Guidelines Revision

Legislation may be introduced to revise the current child support guidelines originally enacted in 1989 to reflect changes in child-rearing costs, various tax rates, and income levels.

Background

In any proceeding to establish or modify child support, the court is required to use the child support guidelines set forth in the Family Law Article. The basic child support obligation is determined in accordance with a statutory schedule and then divided between the parents in proportion to their adjusted actual incomes.

The current Maryland child support guidelines follow the Income Shares Model, used in 35 states, which is based on the concept that a child should receive the same proportion of parental income that he or she would have received if the parents lived together. In an intact household, the income of both parents is generally pooled and spent for the benefit of all household members, including any children. A child's portion of these expenditures includes spending for goods used only by the child, such as clothing, and also a share of goods used in common by the family, such as housing, food, household furnishings, and recreation.

Maryland's guidelines were originally enacted in 1989 in response to federal child support mandates. At least every four years, the Child Support Enforcement Administration (CSEA) of the Department of Human Resources is required to review the child support guidelines to ensure that the application of the guidelines results in the determination of appropriate child support award amounts and to report its findings and recommendations to the General Assembly.

Changes Recommended by CSEA

As a result of its latest review, CSEA recommends that the schedule used to calculate the basic child support obligation be revised to (1) reflect updated data on child-rearing costs; (2) adjust for changes in federal, State, and local taxes; and (3) extend the schedule to higher income levels. Legislation to implement these recommendations may be introduced in the 2005 session.

Child Rearing Costs

The current schedule was developed in 1988 and was based on economic estimates of child-rearing expenditures as a proportion of household consumption developed by Dr. Thomas Espenshade using national data on household expenditures from the *1972-73 Consumer Expenditure Survey* conducted by the U. S. Bureau of Labor Statistics. A congressionally mandated federal study on child-rearing costs was conducted in 1990 by Dr. David Betson using data from 1980 to 1986. The revised schedule proposed by CSEA uses the Betson data updated to 2004 price levels.

Changes in Tax Rates

Although the schedule uses the parents' gross income to calculate the basic child support amount, the amounts are converted from net income to gross income using withholding tables for a single obligor. The current schedule is based on 1988 tax rates; the proposed schedule uses 2004 rates for federal, State, and local taxes and FICA.

Income Ceiling

The current schedule uses the combined monthly adjusted actual incomes of both parents and the number of children due support to determine the basic child support obligation. However, the maximum combined monthly income subject to the schedule is $10,000. For parental income above $10,000, the Court of Appeals has indicated that:

> [T]he guidelines do establish a rebuttable presumption that the maximum support award under the schedule is the minimum which should be awarded in cases above the schedule. Beyond this the trial judge should examine the needs of the child in light of the parent's resources and determine the amount of support necessary to ensure that the child's standard of living does not suffer because of the parents' separation. Further, the judge should give some consideration to the Income Shares method of apportioning the child support obligation. *Voishan v. Palma,* 327 Md. 318 (1992).

Incomes have increased since the original adoption of the guidelines 15 years ago, and it is not uncommon for combined monthly incomes to exceed $10,000, which results in more cases falling outside of the guidelines. The revised schedule increases the combined monthly income ceiling to $20,000.

Environment and Natural Resources

Chesapeake Bay Restoration: What Lies Ahead?

In 2004 the General Assembly established the Bay Restoration Fund to reduce nutrient loading to the Chesapeake Bay. In order to meet the State's commitments under the Chesapeake Bay 2000 Agreement, however, additional measures will be needed.

Background

The Chesapeake Bay is America's largest and most productive estuary with 6,000 miles of shoreline and the ability to produce over half a billion pounds of seafood each year. By the early 1980s, however, it became clear that the quality and productivity of the bay was in serious decline. Experts and policy makers generally agreed that many of the bay's problems were due to an increase in nutrient loadings from sewage treatment plants, agricultural use of manures and fertilizers, and urban runoff. In 2002 Maryland was responsible for 20 percent of the nitrogen, phosphorus, and sediment loads to the bay. Runoff from agricultural land contributes the largest source of nutrients (39 percent nitrogen, 43 percent phosphorus) and sediment (70 percent) to the bay from Maryland. Urban runoff contributes 21 percent of the nitrogen, 35 percent of the phosphorus, and 21 percent of the sediment. Specific point sources contribute 26 percent of the nitrogen and 20 percent of the phosphorus.

The Chesapeake Bay Agreements and Maryland's Tributary Strategy

In 1983 the bay states, the District of Columbia (DC), the Chesapeake Bay Commission, and the federal government signed the first Bay Agreement, which set out a list of broad objectives for bay restoration. This was followed by another agreement in 1987, which established more far-reaching objectives, including the goal to reduce nutrient loadings by 40 percent by 2000. By the end of the 1990s, it was increasingly clear that more would need to be done if the bay were to be restored. Amplifying this concern, in 1999 the bay was listed by the U.S. Environmental Protection Agency (EPA) as an impaired water body. In 2000 the Chesapeake Bay Program partners negotiated the Chesapeake Bay 2000 Agreement (C2K), which laid out the framework for delisting the bay by resolving its nutrient and sediment impairments by 2010. As of 2004, the nutrient and sediment reduction goals have been allocated to the states and DC and further broken down by tributary. Maryland's reduction goals are shown in **Exhibit 1**.

Exhibit 1
Maryland's Pollutant Reduction Goals

Pollutant	1985 Loads	2002 Loads	2010 Goal
Nitrogen (million lbs/yr)	82.4	56.7	37.3
Phosphorus (million lbs/yr)	6.8	4.0	2.9
Sediment (million tons/yr)	1.3	1.0	0.7

Source: Chesapeake Bay Program

All jurisdictions are now developing strategies and implementation plans to meet the reduction requirements. The Department of Natural Resources (DNR) released Maryland's Tributary Strategy on April 30, 2004. The strategy includes basin-specific nutrient and sediment control actions necessary to reduce nutrient pollution from every source.

- The agricultural strategy includes a plan to work with Maryland's farm community to implement a range of best management practices (BMPs) on farmland to reduce nutrient and sediment loads. The strategy includes planting cover crops and alternative crops, riparian reforestation, grass buffers, wetlands creation, implementing nutrient management plans on all farms, and recycling or transporting all excess manure out of the watershed.

- The urban nonpoint source strategy acknowledges that urban development, impervious surfaces, and sprawl development have a profound influence on the quality of Maryland's rivers. The strategy includes a plan to address these impacts through stormwater treatment of developed land, reduction of nitrogen from septic sources, reduction of residential fertilizer use, and a sound land use/growth management strategy.

- Point sources are sources attributed to a specific identifiable end of pipe "point." The majority of nutrient point source discharges are from wastewater treatment plants (WWTPs). The principal point source strategy is upgrading all major WWTPs with enhanced nutrient removal technology. Funding for the upgrades was established during the 2004 session; the Bay Restoration Fund, established by Chapter 428, Acts of 2004 will provide grants to WWTP owners to upgrade their facilities. The fund will also provide (1) grants and loans to septic system owners to upgrade their systems and (2) additional funding for the State's cover crop program.

- Also of concern is the atmospheric deposition of nutrients directly onto the land and surface waters within the watershed. Air pollutants comprise anywhere from a quarter to a third of the total nitrogen load entering the bay each year. The air reduction strategy is developed and implemented by EPA.

Future Policy Actions Will Be Needed

Following the adoption of the Tributary Strategy by the Governor in spring 2004, public input was sought to identify implementation issues. According to DNR, the State's implementation plan, which will be presented to the Governor and the Bay Cabinet this fall, will be completed in December 2004. The plan will include several components, including a schedule for BMP implementation, barriers to implementation, legislative and other policy changes that will be needed, and actions necessary to address funding issues. The Tributary Strategies Implementation Steering Committee, led by DNR, is developing policy actions to be included in the plan. Although still being developed, examples of the draft recommendations include:

- increasing funding for State and local sediment and erosion control programs through increases in permitting fees and fines;
- increasing funding for local governments to implement stormwater management projects;
- funding a study on the potential policy approaches to change residential fertilizer application behavior;
- completing a study on septic systems to better inform policymakers about potential policy options;
- establishing a Governor's task force to provide policy direction relating to growth management;
- increasing funding for nutrient management plans and Maryland's cover crop program; and
- renewing and expanding tax incentives that encourage reductions in air pollutants.

Funding a Major Concern

According to DNR, the capital cost to implement Maryland's tributary strategy is currently estimated at $6.1 billion from 2003 through 2010; ongoing operating costs are estimated at $3.8 billion over the eight-year period. DNR advises that anticipated funding from existing federal, State, and local sources totals approximately $4.4 billion, which leaves a funding shortfall of approximately $5.5 billion from 2003 through 2010. Cost estimates will continue to be revised as the implementation plan is developed.

In October 2004 the Chesapeake Bay Watershed Blue Ribbon Finance Panel, charged with developing innovative solutions to financing the bay restoration effort, called on bay states and the federal government to make a six-year, $15 billion investment in the creation of a regional finance authority to prioritize and distribute restoration funds throughout the watershed.

Environment and Natural Resources

Fisheries Management

Fisheries management is most meaningfully viewed in the context of the Chesapeake Bay's current oxygen depletion levels coupled with the hope of water quality restoration. Even amidst unsafe mercury levels in some fish and the evident decline of others, some species appear to be rebounding. Likely to be of most pressing concern in the 2005 session will be the introduction of nonnative oysters.

Scientists and State officials remain concerned about the steady deterioration of water quality throughout the Chesapeake Bay watershed and the effects of that deterioration on native fish. Huge influxes of nitrogen continue to wash into the bay depriving fish of oxygen, blocking sunlight from reaching underwater grasses, and eventually leaving large areas of bay water unable to support fish and underwater vegetation. In addition, pollution has resulted in high mercury levels in some fish species, creating a human health risk. Despite the current negative outlook, there is some positive news with respect to the State's fisheries.

Status of State Fisheries

The decline in bay water quality has led to a general decline in many, but not all, State fisheries. **Exhibit 1** shows data on harvests of four major commercial fisheries.

Exhibit 1
Selected Commercial Fishery Annual Harvests
(in Thousands of Pounds)

	CY 1993	CY 1997	CY 2002	CY 2003	CY 1993 – 2003 Change
Blue Crab	53,638	41,306	25,011	26,638	-54%
Menhaden	2,257	3,318	4,023	3,002	33%
Native Oyster	519	1,508	567	174	-66%
Rockfish	950	2,213	1,853	1,826	92%

Source: Department of Natural Resources

Blue Crab

Harvests of blue crabs are at low but stable levels. The Chesapeake Bay Program reported in June that the number of blue crabs had improved in 2003 compared to the previous four years. However, the number of female spawning crabs in the species' spawning grounds near the mouth of the bay has not increased, and the Department of Natural Resources (DNR) has reported a slight dip in the abundance of crabs bay-wide since 2003. Interestingly, while blue crab harvests decreased 54 percent between 1993 and 2003, the dockside value per pound of the blue crab harvest increased 106 percent over that time period.

Menhaden

Menhaden serves as a food source for rockfish, bluefish, and weakfish and filters water of nutrients that depress oxygen levels. The species also has many commercial uses; its oil is used for omega-3 fatty oils as well as products for animal feed and cosmetics. Because of its ecological role and concerns over the future of the stock given poor reproduction, the Atlantic States Marine Fisheries Commission (ASMFC) considered further restrictions on the fishing of menhaden. Some environmentalists argue that without immediate action, the fishery will soon be in crisis. Rather than restrict harvesting, the ASMFC Menhaden Management Board decided at its November 2004 meeting to order more extensive research.

Native Oyster

While the 1997 harvest saw gains of almost 190 percent in oyster catches compared to 1993, the 2003 oyster harvest was well below the 1993 harvest, down 66 percent to 174,406 pounds. At its peak, the bay's oyster population acted as a natural filter in the bay, removing 133 million pounds of nitrogen annually. Today the oyster population has dropped to less than one-half of 1 percent of its original population, and the few remaining oysters remove only about 250,000 pounds of nitrogen from the bay each year. Largely due to two diseases, MSX and Dermo, the oyster stock is severely depleted. High salinity levels in the bay and its tributaries have hindered oyster replenishment programs. The State is considering a nonnative oyster program, discussed below, that would introduce disease-resistant oysters in hopes of reestablishing oysters in the bay.

Rockfish (Striped Bass)

Maryland has seen a 92 percent increase in the total volume of rockfish harvested between 1993 and 2003. Annual rockfish catches are subject to quotas established by ASMFC to keep the fish plentiful in the bay. A five-year moratorium was instituted in the late 1980s to combat a declining population. As a result of these measures, rockfish is abundant and one of the strongest fisheries in the bay. The 2003 harvest had a total dockside value of $3,291,685, which is 8 percent higher than the 1997 value despite taking 18 percent less rockfish.

Introduction of Nonnative Oysters to the Bay

The most pressing fisheries issue in 2005 will likely be the possible introduction of a nonnative oyster species to the bay. To both revive the oyster industry and replace the bay's natural filters, the State is studying the introduction of the nonnative Suminoe or Asian oyster, among other options. The Suminoe oyster has shown disease resistance and grows quickly. A small population of a strain of the Suminoe oyster has been maintained in aquacultures off the coast of Oregon for about 30 years. Despite the existing data, however, the Suminoe's survival near Oregon does not answer questions about its possible survival in, and possible impact on, the bay.

Status of Current Research on Nonnative Oysters

A number of organizations have studied or begun to study the possible effects of the introduction of the Suminoe oyster into east coast waterways. The National Academy of Sciences (NAS), in a report on the Suminoe oyster published earlier this year, conceded that the oyster seems more disease resistant than the native oyster but stressed that the results of their study were preliminary. NAS suggested that longer-term studies of the nonnative oyster, up to five years, were needed before a determination could be made as to the likely effects of a nonnative oyster program.

Maryland, Virginia, and the U.S. Army Corps of Engineers are voluntarily preparing an environmental impact statement (EIS) on the possible introduction of the Suminoe oyster to the Chesapeake Bay. The EIS will consider eight different options regarding oysters ranging from continuing the current native oyster restoration program to introducing and propagating a nonnative oyster species while ending native oyster restoration efforts. DNR anticipates a draft version of the EIS being ready for public review in February 2005, with a final version published in June 2005. The information in the EIS will lead to a decision on whether or not to introduce the nonnative oyster. DNR advises that it would like to preserve the existing native oyster where it can but that the need for natural filtration for bay restoration is too great to let the issue of introducing nonnative oysters go unstudied.

Issues Surrounding the Suminoe Oyster and the Chesapeake Bay

DNR's timeline for the completion of the EIS is aggressive, particularly when compared to the considerably longer timeline advocated by the NAS report. However, the NAS report focused on the native Suminoe oyster in its natural habitat in Asia, while DNR is proposing to introduce a similar strain of the Suminoe oyster currently found in the United States. In addition, given the existing research on this particular strain of oysters and the inherent risk of introducing a nonnative species into a fragile ecosystem, thought will have to be given as to how much research is enough. Other issues, such as DNR's plans for how to introduce the nonnative oyster, will be important components of any decision. Finally, DNR's ultimate decision will need to be weighed against the financial cost of continuing the current native oyster programs.

DNR expects that these questions will be answered by the EIS but stresses that Maryland and Virginia "will not proceed with the introduction of the nonnative oyster if unacceptable risks are identified." Moreover, DNR has stated that both states will move forward in the same direction. Regardless of the conclusions of the EIS, conflict likely will remain between those who favor delaying the introduction of the Suminoe oyster until further studies have been completed and those who believe that concerns have been satisfactorily addressed and that an immediate introduction of the oyster is needed to restore the bay and the nearly extinct oyster industry. Legislation proposing to explicitly prohibit or permit such an introduction is likely to be introduced during the 2005 session.

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Environment and Natural Resources

Methyl Tertiary-Butyl Ether and Groundwater Contamination

Recent contamination of wells in Harford County has increased concern about the fuel additive methyl tertiary-butyl ether. Although the State is developing regulations to address these concerns, it is likely that legislation will be introduced during the upcoming session.

Background

Methyl tertiary-butyl ether (MTBE) is a chemical compound used as a gasoline additive. It raises the oxygen content in gasoline, which helps engines burn cleaner, thus reducing tailpipe emissions. It was originally introduced in the late 1970s to replace lead. MTBE is being used at higher concentrations in some states, such as Maryland, to fulfill the oxygenate requirements set by Congress in the 1990 federal Clean Air Act amendments.

At room temperature, MTBE is a volatile, flammable, and colorless liquid that dissolves easily in water. Because MTBE is more water soluble and less biodegradable than other gasoline components, it can be introduced into groundwater from leaking underground and aboveground petroleum storage tanks. Recent studies indicate that MTBE vapors can also lead to groundwater contamination. Low levels of MTBE can make drinking water undrinkable due to its offensive taste and color. Although there is limited data on the human health effects of MTBE when ingested through drinking water, the U.S. Environmental Protection Agency has advised that MTBE is a potential human carcinogen at high doses.

Legislation enacted in 2000 established a task force to study the environmental effects of MTBE. In its final report the task force noted, among other things, that Maryland should give careful consideration to a reduction or a complete phase-out of MTBE in gasoline sold in the State provided there is no backsliding on air quality benefits.

MTBE Concerns Prompt Action in Other States

Twenty states have either partially or completely banned the use of MTBE statewide. Another 10 states have passed legislation, or have legislation pending, that signals an eventual phase-out of MTBE. Some of this legislation directs state agencies to study the effects of MTBE or creates councils and commissions to monitor the progress of a phase-out. New Hampshire recently enacted legislation that requires notification of property owners, public water suppliers, and health officers when groundwater contamination is discovered. Overall, partial bans are the most common form of prohibiting MTBE among these states. Partial bans permit trace amounts of MTBE in motor vehicle fuel sold or used in the state. A number of the partial bans will become complete bans within a few years, allowing industries to find viable alternatives to MTBE.

MTBE in Maryland

Currently, there are no laws or regulations limiting the use of MTBE in gasoline sold in Maryland. However, the Maryland Department of the Environment (MDE) does have action levels when MTBE is detected in both public and private water supplies. In public water supplies, when MTBE is detected at levels over 10 parts per billion (ppb), MDE increases sampling frequency and conducts an investigation to determine the source of the contamination. For private wells, treatment is recommended for wells with levels above 20 ppb. Treatment can include additional monitoring, finding alternative sources of water, and well replacement. Maryland has no laws or regulations that require notification of groundwater contamination to potentially affected residents.

With the recent discovery of high levels of MTBE in groundwater in Harford County, State officials have begun to develop regulations aimed at preventing MTBE contamination. Although contamination in Harford County was first discovered in 1998, the more recent discovery, at levels as high as 1,520 ppb, is being traced to up to seven gas stations in the Fallston area. These discoveries have prompted Harford County to institute a 180-day moratorium on the construction of new gas stations until the source of the contamination can be identified.

While many residents in the Fallston area are calling for a ban on MTBE, MDE is currently developing regulations that would result in an increased monitoring of gas stations, including requiring leak sensors, alarms, and monitoring wells. These regulations may also require gas stations to replace all underground fuel pipes to provide extra protection against future leaks. Gas station owners and operators argue that such improvements would be too costly. Local environmental groups argue that such requirements fall short of what is needed.

Grain farmers on the Eastern Shore see ethanol as a potential substitute for MTBE. Ethanol, which is made from grains including corn, wheat, oats, and barley, is the additive used by states that have banned MTBE. It is just as effective as MTBE in reducing tailpipe emissions, but it is nontoxic, water soluble, and quickly biodegradable. A feasibility study has been planned to evaluate the possibility of building an ethanol plant on the Eastern Shore.

Implications for the 2005 Session

State officials are currently developing proposed regulations and hope to have them finalized by the end of the year. Despite the development of regulations, it is likely that legislation will be introduced during the 2005 session to address the issue.

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Environment and Natural Resources

Special Funded Programs Face Challenges

Special fund revenues associated with natural resource, environmental, and agricultural programs are not keeping pace with program costs. Outdated fees, combined with increasing competition for general funds and budget reconciliation diversions, have had a significant impact on the overall funding of these programs.

Background

In recent years, increasing competition for general funds and limited growth in special fund revenues has led to modest funding increases for Maryland's natural resource, environment, and agriculture programs. Between fiscal 2000 and 2005, operating budget increases for the Department of Natural Resources (DNR), the Maryland Department of Agriculture (MDA), and the Maryland Department of the Environment (MDE) averaged 2 percent annually. Special fund growth for these agencies over that period averaged less than 1 percent annually; this is significant because these agencies rely on special funds for approximately 36 percent of their operating budgets.

Special Fund Fee Legislation

Outdated fees, along with the strong competition for general funds, have prompted legislative proposals aimed at increasing special fund revenues by establishing new or increasing existing fees. During the 2004 session, numerous fee proposals were introduced. Examples of fee legislation introduced, but not adopted, include:

- House Bill 181, which would have increased various fees paid to DNR under the State Boat Act;
- Senate Bill 54, which would have increased annual registration fees and established a new fee under MDA's Weights and Measures Program;
- Senate Bill 60, which would have increased the fees for recreational fishing licenses issued by DNR;
- House Bill 495, which would have established fees to support MDE's Wetlands and Waterways Program;
- House Bill 496, which would have authorized DNR to adopt regulations to establish fees for participation in or access to wildlife programs and services; and

- Senate Bill 762/House Bill 1259, which would have repealed specified DNR fee amounts set in statute and established a commission responsible for identifying appropriate fee levels and establishing them through regulation.

The General Assembly adopted the following fee legislation during the 2004 session:

- Chapter 428, which established a bay restoration fee to fund nutrient removal upgrades to wastewater treatment plants, a grant and loan program for septic system upgrades, and additional funding for the State's cover crop program;

- Chapter 245, which established fees to support the operations of the State Board of Veterinary Medical Examiners;

- Chapter 180, which modified provisions relating to waterfowl outfitter and hunting guide licenses and associated fees; and

- Chapter 430, which, as part of the budget reconciliation legislation, increased lead registration fees within MDE, and pesticide registration, plant protection, and turf and seed fees within MDA.

Special Funds Used to Help Balance the Budget

In recent years, the General Assembly has diverted significant special fund revenues and fund balances from DNR, MDA, and MDE programs to balance the State's operating budget. The Budget Reconciliation and Financing Act (BRFA) of 2004 (Chapter 430) raised several fees that increased agency operating budget special funds by approximately $500,000, as described above, but made corresponding decreases in general funds for those programs. BRFA of 2004 also diverted $189.3 million in transfer tax revenues to the general fund, thereby reducing funding for DNR's Program Open Space and MDA's agricultural land preservation program; less than 10 percent of this funding was replaced with general obligation bond funding. BRFA of 2003 diverted $19.0 million in Waterway Improvement Fund fiscal 2004 revenues and fund balances to the general fund.

Implications for the 2005 Session

In light of continuing budget constraints, the General Assembly is likely to consider both fee and budget reconciliation legislation during the 2005 session. Stakeholder work groups have convened during the 2004 interim to evaluate and make recommendations regarding the establishment of fees within MDE's Wetlands and Waterways Program and the creation of a fee-setting commission within DNR. In addition, continued concern about the diversion of DNR and MDA special funds to the general fund may prompt legislation that would require general fund "reimbursements" or "repayments" for lost special fund revenue.

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State Government

Sale of State Assets

The State's current fiscal imbalance has prompted the Governor to conduct an inventory of State-owned real property that could be sold. Regulations governing such asset sales are relatively sparse, meaning that processes for evaluating and selling State assets must be developed. The costs and benefits, both short- and long-term, of such sales must be carefully evaluated.

State Real Property

Shortly after taking office, Governor Robert L. Ehrlich, Jr. directed the Maryland Department of Planning (MDP) and the Department of General Services (DGS) to develop an Asset Maximization Plan with the intent of identifying underutilized or surplus State-owned property that could be sold. MDP initially completed an inventory assessment in the summer of 2003, utilizing their web-based MD Property View System, which resulted in the identification of 13,584 State-owned real property parcels with an estimated cash value in excess of $8 billion. As expected, the Maryland Department of Transportation (MDOT) and the Department of Natural Resources (DNR) account for most of the State-owned real property parcels representing ownership of 11,711 or 86 percent of the parcels comprising 460,215 or 92 percent of the total acreage.

As a component of the plan, MDP then launched a statewide review process to identify excess properties on the inventory list. While the MDP review process is only partially complete, so far 143 parcels, comprised of 73 MDOT parcels, 54 DNR parcels, and 16 other agency parcels, have been declared excess to agency needs. The Asset Maximization Plan provides that all properties ultimately declared excess will be systematically put through the "MDP Clearinghouse Process" before a proposal for disposition of the property is presented to the Board of Public Works (BPW).

MDOT and the University System of Maryland (USM) will handle the sales of their excess property. It appears that USM has few excess properties. MDOT's Office of Real Estate Development (ORED) is handling its sale of excess real property. ORED developed a web site to market excess properties, as well as other property that may hold some economic development potential near other MDOT facilities. As of April 2004, the web site listed 160 excess properties in the clearinghouse process. Just as with other agencies, MDP acts as a clearinghouse for the sale of MDOT property by polling other interested parties such as State agencies and local governments. However, MDOT will handle the marketing and sales. The final sale must be approved by the Board of Public Works.

Property Disposition Statutory and Regulatory (Clearinghouse) Process

Sections 5-310 and 10-305 of the State Finance and Procurement (SF&P) Article address the disposition of State excess real property. In addition, MDP recently adopted regulations concerning excess property under Title 14, Subtitle 24, Chapter 5 of the Code of Maryland Regulations (COMAR).

The statutory and regulatory process operates as follows:

State agencies notify MDP of excess property under their control (SF&P § 5-310; COMAR 14.24.05.04A).

- MDP studies the proper disposition of the property, determines whether other State agencies or local governments are interested in the property ("Clearinghouse review process"), and makes appropriate recommendations to agencies and the Board of Public Works (SF&P § 5-310; COMAR 14.24.04B,C,D,E).

- BPW determines whether excess property should be (1) disposed of to another government unit; (2) retained by the State; or (3) declared "surplus" and disposed of to anyone (COMAR 14.24.05G). Surplus property is defined as property BPW has determined is not needed and may be disposed of (COMAR 14.24.05.03E).

- Following BPW determination, either DGS or MDOT disposes of the property subject to the conditions imposed by BPW (COMAR 14.25.05.05).

- Final disposition of any real property is subject to BPW approval for consideration BPW decides is adequate (SF&P 10-305(a)).

According to the statutory and regulatory requirements, a property is supposed to be declared surplus by BPW before it is marketed for sale. In practice, however, BPW is often asked by DGS, MDOT, MDP, and USM to make a determination that a property is surplus at the same time it is presented with a contract of sale for its consideration and approval. In effect, BPW is concurring that property is surplus – it passed Clearinghouse review – and approving the sale consideration concurrently. While concurrent consideration may be more efficient, it does not appear to follow statutory and regulatory guidelines.

In part to secure a voice in the property disposition process, the General Assembly amended SF&P § 10-305 through the Maryland Consolidated Capital Bond Loan of 2004, Chapter 432 of 2004. The amended statute now requires that prior to BPW approval of the sale of any State-owned property with an appraised value over $100,000, the Senate Budget and Taxation Committee and the House Committee on Appropriations must receive a written description of the property in question. The committees are also provided with a 45-day review and comment period concerning proposed sales. The provision does not expressly address conveyances by means other than sale, nor, it appears, does State law presently require that an appraisal of the property be conducted.

Real Estate Portfolio Consultant Services Procured

A major element of the Administration's Asset Maximization Plan took shape when on June 23, 2004, BPW approved a DGS contract with The Staubach Company for real estate portfolio consultant services. The contract, valued at $750,000, consists of two phases. Phase I requires Staubach to identify and evaluate all real property data bases; assist in developing a single, all inclusive real property portfolio inventory system; develop a management model for the State's real property assets to include a review of master planning strategies for facilities programming; and make recommendations on buy versus lease analysis, leasebacks, capital leases, utilization of State-owned space, and excess property determinations. Moreover, Staubach is also required to identify a minimum of two strategies that could result in $5 million of cost savings or increased revenue within two years. Before the end of the base contract period, Staubach must present a follow-up work plan with Phase II strategies or projects that have the potential to realize an additional $10 million in revenue or cost savings. The work plan will be used to review cost savings and/or income-producing strategies developed by Staubach before committing to the option period of the contract.

Disposition of Proceeds

The remainder of this paper provides a summary of the requirements and exceptions concerning the disposition of proceeds derived from the sale of State assets. Generally, if cash is received as payment, it must be deposited into the State Annuity Bond Fund Account for the payment of principal and interest on outstanding bonded indebtedness. However, if the property was originally acquired with money from a special fund, the cash must be deposited into that special fund. For example, the proceeds of the sale of property acquired by the Transportation Trust Fund must be deposited into the Transportation Trust Fund, and proceeds from the sale of Program Open Space property go to the Advance Option and Purchase Program as required under § 5-904(b) of the Natural Resources Article. In addition, if cash is received in exchange for transfer of a capital asset, other than real property (*e.g.*, land patents), the cash may be paid into the State Treasury. If real or personal property is received in exchange for the real or personal property of the State or a unit of State government, the property received shall be held and accounted for in the same manner as other property under the control of the unit.

Exceptions

Maryland law provides the following exceptions to these rules for certain sales or exchanges by the University System of Maryland, the Developmental Disabilities Administration and Mental Hygiene Administration of the Department of Health and Mental Hygiene, and the Department of Natural Resources:

- If the University System of Maryland sells real property, proceeds of the sale may not be deposited into the Annuity Bond Fund Account and instead may only be used, with the approval of the Board of Public Works, for the purchase or improvement of university property and facilities.

- The proceeds of the sale or long-term lease of property and equipment of a Developmental Disabilities Administration facility or a Mental Hygiene Administration facility must be deposited into the Community Services Trust Fund.

- The Department of Natural Resources may dispose of any existing structure on property acquired by the State for DNR's use if the property is valued at $2,500 or less. The proceeds must be credited to the Natural Resources Property Maintenance Fund.

In addition, if a property was purchased using federal funds or for a federally funded project, such as a highway project, the federal government requires that these funds be returned to the federal government. If a state sells or leases federally funded infrastructure assets, the state must repay the depreciated value of the federal grant.

Special rules, including time frames and potential purchasers, apply to the disposition of State Highway Administration property no longer needed for public purposes, such as acquired right-of-way. In addition, the release of a lot from an agricultural land preservation easement is governed by the requirements of the Agricultural Land Preservation Program.

Conclusion

There are potential benefits to be derived from a property disposition plan, including (1) increased State revenues through the sale of unneeded property; (2) increased local government property tax revenues by moving surplus property into the private sector; (3) and potential cost savings to the State through reductions in operating costs of unneeded property. However, significant issues remain including (1) ensuring that the marketing process is fair and open for competitive opportunities; (2) establishing methods for determining fair market value; and (3) dealing with "bad money" issues that stem from the sale of properties that have been improved using tax-free general obligation bond funds.

As a highly visible component of the Governor's agenda, the legislative leadership and budget committees should consider being briefed by DGS and MDP concerning the Asset Maximization Project and its relationship to future budgets.

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State Government

Study to Review Procurement Law Exemptions

As a result of 2004 legislation that requires the Department of Legislative Services (DLS) to undertake a study of exempt entities under the State procurement law, DLS has issued a report to the Governor and the General Assembly.

Background

Maryland's current procurement law, which took effect in July 1981, was the result of an intensive study from 1977 through 1980 and generally patterned after the Model Procurement Code developed by the American Bar Association. It centralized full authority over all State procurement in the Board of Public Works, with the board given "power and authority over the procurement, management, and control of all supplies, services, construction, and other items procured by the State."

While the board is the principal procurement authority, in practice it has delegated most of its responsibility for procurement to primary procurement units. Moreover, although the basic substance of the procurement law has remained fairly consistent over the 24 years since the original enactment, a number of substantive changes to the procurement law have granted additional flexibility or outright exemptions from the law to some State entities. From time to time over the years, concerns have been expressed by legislators and other interested parties about the growing number of exempt entities. Most recently, in its review of the procurement law during the 2003 interim, the Task Force to Study Efficiency in State Procurement discussed the growing number and status and lack of oversight of exempt entities. Nonetheless, the task force did not make a specific recommendation on this issue.

During the 2004 session, the controversy over exempt entities was heightened further when in February 2004 the Office of Legislative Audits released an audit of the Maryland Stadium Authority, one of the more prominent exempt entities. Among other findings, the audit found that the Stadium Authority had not established formal written procurement procedures and several construction contracts totaling in excess of $66 million were awarded without being publicly advertised.

In order to gain more information and a better understanding about exempt entities, Chapter 469 of 2004 requires the Department of Legislative Services (DLS) to undertake a study of exempt entities under the State procurement law. DLS must review each State entity that is exempt from any portion of the State procurement law regarding:

- the extent of the exemption;

- the original justification for the exemption and whether the circumstances continue to exist that justified the original exemption;

- any procurement policies or procedures developed by the entity and the extent to which the policies and procedures comply with the purposes of State procurement law;

- the existence of any accountability measures for determining the efficiency, effectiveness, and economy with which the entity is using State resources; and

- the date of, and findings from, the most recent legislative audit of the entity.

In addition, Chapter 469 directs the Board of Public Works to examine the level and extent of the delegation of its procurement responsibilities to units of State government and whether there are appropriate safeguards and accountability measures in place to promote the purposes of the procurement law.

Both DLS and the board are required to issue a report of findings (and in the case of the board, any recommendations for revisions to procurement law or regulations) to the Governor and the General Assembly by December 1, 2004.

Survey

During the 2004 interim, DLS surveyed each State entity that is exempt from any portion of the State procurement law requesting the information specified in Chapter 469. The survey posed the following questions:

(1) On what specific basis (quasi-public entity, business enterprise financing requirements, etc.) was your agency initially exempt from State procurement law?

(2) Does the condition(s) for which your agency was initially granted an exemption from State procurement law still exist? If so, please provide detailed quantifiable data to support the condition's continued existence.

(3) Is your agency required to comply with any portion of State procurement law? If so, please provide specific statutory citations.

(4) Does your agency have written procurement policies and procedures? If so, please provide two hard copies with your response.

(5) If your agency does not have written procurement policies or procedures, on what basis is your agency in compliance with State procurement law?

(6) Has your agency developed any accountability measures for determining the efficiency, effectives, and economy with which your agency utilizes State resources (*i.e.*, Managing for Results Outcomes)? If so, please provide a copy of the accountability measures and three years of performance data related to each measure.

(7) Please provide a three-year history (FY 2003 Actual, FY 2004 Legislative Appropriation, and FY 2005 Legislative Appropriation) of your agency's procurement spending for the following objects in the State budget: (1) Object 6 – Fuel & Utilities; (2) Object 7 – Motor Vehicles; (3) Object 8 – Contractual Services; (4) Object 9 – Supplies & Materials; (5) Object 10 – Equipment-Replacement; (6) Object 11 – Equipment-Additional; (7) Object 14 – Land & Structures. Provide sub-object detail for each object where applicable. Nonbudgeted agencies should contact DLS for assistance

Based on the exemptions found in the State procurement law, the majority of which are found in Title 11, Subtitle 2 of the State Finance and Procurement Article, approximately 30 entities were surveyed.

Report

The final DLS report to the Governor and the General Assembly on exempt entities includes information on the background and justification for the procurement law exemptions and an overview of the procurement policies, procedures, and oversight of exempt entities. The report summarizes the entities' responses, notes general observations gleaned from the survey responses, and includes an appendix containing a hard copy of each survey response. General observations from the survey responses include:

- a misunderstanding by some entities of the justification and scope of the applicable procurement exemptions;
- a lack of written procurement policies and procedures by some entities; and
- minimal procurement oversight.

Additionally, the report considers the most recent audit for each exempt entity by the Office of Legislative Audits and highlights information on procurement-related findings from the audits. Further, the report provides anecdotal information about the magnitude of the dollars spent by some of the exempt entities outside the standard procurement law process.

State Government

Code Revision

The next project for the ongoing nonsubstantive revision of the Annotated Code of Maryland is the Housing and Community Development Article which is to be introduced in the 2005 session. Two other proposed revised articles are being reviewed by article review committees and are planned for introduction in the 2006 and 2007 sessions.

Background

The process known as "Code Revision," which is the nonsubstantive bulk revision of the Annotated Code of Maryland, started in the early 1970s. Since 1990, the Code Revision Committee, chaired by the Honorable Alan M. Wilner, a judge on the Court of Appeals, has been charged with the oversight and continuing development of code revision. The committee makes recommendations to the President of the Senate and the Speaker of the House on the order in which articles are to be revised and on the membership of the various article review committees that review the drafts produced by legal staff of the Office of Policy Analysis.

There are currently three revised articles in preparation: the Housing and Community Development Article (for introduction in part in the 2005 session and in part in the 2006 session), the Economic Development Article (for introduction in part in the 2006 session and in part in the 2007 session), and the Human Services Article (for introduction in the 2007 session). The remaining articles to be created are the Local Government Article, the Land Use Article, and the Alcoholic Beverages Article. **Exhibit 1** outlines the current and future code revision projects and their anticipated introduction dates.

Exhibit 1
Current and Future Code Revision Projects

Name of Article	Expected Introduction Date
Housing and Community Development Article	2005 and 2006
Economic Development Article	2006 and 2007
Human Services Article	2007
Local Government Article	Not Yet Scheduled
Land Use Article	Not Yet Scheduled
Alcoholic Beverages Article	Not Yet Scheduled

Source: Department of Legislative Services

Housing and Community Development Article

The Housing Article Review Committee is chaired by Franklin B. Olmsted, Esquire, who is a member of the Code Revision Committee. This interim the committee completed its review and revision of statutes relating to housing, community and neighborhood development, and historical and cultural programs for introduction in the 2005 session. It will continue its review of provisions relating to housing authorities to be revised in legislation introduced in the 2006 session.

The Housing and Community Development Article will contain revised provisions that relate to housing and community development, other than the provisions relating to building and material codes that have been revised in the Public Safety Article. It will also contain provisions currently found in Article 44A of the Code relating to housing authorities when those provisions are revised and added to the article next year.

Economic Development Article

The Economic Development Article Review Committee is chaired by Susanne Brogan, Esquire, who previously served as a commissioner on the Public Service Commission, legislative counsel to former Speaker R. Clayton Mitchell, and a legislative analyst in the former Department of Legislative Reference. The article review committee began meeting on October 8, 2003, and expects to have a bill ready for at least the statewide provisions allocated to the article for introduction in the 2006 session.

When complete, the Economic Development Article will contain revised provisions that relate to State, regional, and local economic development.

Human Services Article

The Human Services Article Review Committee is chaired by Bonnie Kirkland, Esquire, an assistant Attorney General, who previously served as Special Secretary for Children, Youth, and Families, chief legislative officer during part of the Glendening Administration, and committee analyst and manager in the former Department of Legislative Reference. The article review committee began meeting on September 17, 2003, and expects to have a bill ready for introduction in the 2007 session.

The Human Services Article will contain revised provisions that relate to human resources; juvenile justice; children, youth, and families; individuals with disabilities; and the elderly.

State Government

Election Administration

Following extensive scrutiny and court challenges, Maryland's new statewide electronic voting system makes its debut for the 2004 elections as the State Board of Elections pushes forward to implement the requirements of the Help America Vote Act of 2002.

Voter Verified Paper Trail/Audit

Chapter 564 of 2001 required the State Board of Elections (SBE) to select a uniform statewide voting system for voting at polling places. In January 2002, SBE entered into a $55 million contract to purchase over 16,000 electronic touchscreen voting units and services from Diebold Election Systems, Inc. All local jurisdictions implemented the new voting system for the March 2004 presidential primary election, with the exception of Baltimore City, which is exempt from the requirement to implement the new voting system until 2006 because it had purchased a new voting system in the 10 years prior to 2001.

A report released on July 23, 2003, by Aviel D. Rubin and several other researchers from Johns Hopkins University and Rice University, entitled *Analysis of an Electronic Voting System* (the Rubin report), concluded that the Diebold software was vulnerable to hackers, multiple voting, vote switching, and interception and manipulation of election results. Governor Robert L. Ehrlich, Jr. then ordered an independent review of the Diebold voting system by the Science Application International Corporation (SAIC). The SAIC report identified some technical and procedural security vulnerabilities in the voting system. During the 2003 interim, leaders of the Senate and House of Delegates requested the Department of Legislative Services (DLS) to conduct its own review of the security issues flowing from the risk assessment commissioned by the Governor. This DLS review confirmed the findings of the previous assessment and uncovered additional software, hardware, and operational vulnerabilities. RABA Technologies, Inc., contracted by DLS to assist in the security review, recommended the use of a voter-verified paper trail/audit (VVPT) as necessary in some form.

The Rubin report, the SAIC report, and the RABA report all raised concerns over the vulnerabilities of electronic voting software to hackers or substandard computer code and the ease with which the voting units themselves can be manipulated either physically through tampering or through the use of other electronic devices to intercept and modify election results. As a result, Maryland – among other states including Ohio, Nevada, and California – has received extensive media coverage about the security and accuracy of electronic voting systems. The media coverage and outpouring of public concern has caused some voters to request an add-on printer that produces a VVPT for the electronic voting systems.

The use of VVPT originated as a way to detect some types of irregularities in a direct recording electronic (DRE) voting system. VVPT would allow a voter to review a paper printout of the voter's selections and change the selections before casting a final vote. The paper record would serve as the official ballot and be used in the event of a recount, since it is assumed that a voter specifically verified the document and it thus would be the best indication of voter intent. In the past few years, 18 states have considered some form of VVPT legislation. Oregon and California now require VVPT for the 2006 elections. The Secretary of State of Nevada mandated VVPT beginning with the November 2004 presidential election.

Senate Bill 393/House Bill 53, introduced during the 2004 session, would have required the State's uniform electronic touch screen voting system to produce a paper record of each vote cast and then allow the voter to inspect, verify, and correct any errors made on the ballot before the paper record is preserved at the polling place. The legislation failed, however.

Nonetheless, in April 2004 a voting activist organization based in Takoma Park, Maryland filed a lawsuit against SBE to request that SBE decertify the electronic touchscreen voting system in accordance with federal and State law in light of the security vulnerabilities uncovered in the various security assessments and to require that the machines be retrofitted with a VVPT. In advance of the trial, the plaintiffs requested the court to issue a preliminary injunction to require SBE to give voters an option to cast their vote by paper ballot (both parties stipulated that implementing a VVPT before the November general election was not possible). The court denied the plaintiffs' motion and in its written opinion stated that the paper ballot option is "not feasible" and "cost prohibitive." Further, the court was satisfied with the security measures already taken by SBE and found that there had been no verified incidences in the United States of tampering with electronic voting machines.

In view of the widespread interest in VVPT, Diebold has developed a printer add-on prototype that may be used with its current DRE voting system. Projected costs for adding VVPT to Maryland's electronic voting system have been estimated at $6 to $16 million based on other states' costs and estimates for similar upgrades. This upgrade would be subject to the federal voluntary voting system standards to which Maryland is a signatory. However, these standards do not currently include guidelines for paper record printers on DRE voting system units. The Federal Election Commission advises that standards are in the process of being developed in conjunction with the National Institute of Standards and Technology and the Election Assistance Commission, the agency responsible for enforcing the Help America Vote Act (HAVA). Any upgrade to the current voting system must also undergo a state certification test as well as independent testing and validation at the local level to verify the functionality of the entire voting system.

Despite the ongoing controversy surrounding the State's new touch screen electronic voting system, the 2004 primary and general elections appear to have been concluded smoothly, with generally widespread voter satisfaction with the performance of the new voting system.

Help America Vote Act Compliance

SBE has received a total of $49.8 million under the federal Help America Vote Act of 2002 for the cost of replacing lever machines and complying with the voting system requirements under the Act. In addition, SBE has received $376,305 under HAVA for the purpose of making polling places accessible to voters with disabilities. SBE anticipates that these federal funds will be depleted by fiscal 2008. However, the ongoing costs of maintaining the uniform electronic voting system; the development, implementation, and maintenance of a centralized voter registration system; and installment payments on the electronic voting system will continue in the out-years. **Exhibit 1** details how SBE has allocated the HAVA funds it has received to date.

Exhibit 1
Allocation of HAVA Funds Received by SBE through Fiscal 2005

Activity	Expenditure
Voting System Security	$305,000
Voter Outreach	954,000
Voting System Services	4,518,262
Voting System Installment Payments	11,233,176
Election Reform Office	101,212
Voting System Related Expenses	1,297,836
Total	**$18,409,486**

Source: Maryland State Board of Elections

To date, SBE is in compliance with most of the requirements under HAVA, including provisional voting, disability access, language accessibility, voter information requirements in polling places, overseas and military voting procedures, and establishment of a uniform standard definition of what constitutes a vote. The implementation of a uniform centralized, computerized statewide voter registration list is the final major requirement under HAVA that SBE has yet to complete.

Statewide Voter Registration System

SBE has been developing an automated centralized registration database since 1998. In 2002 HAVA required implementation of such a centralized database that would be controlled and maintained by the State and used as the official registration list for federal elections. The process of developing such a system has proven to be particularly difficult. While SBE requested and was granted a waiver of the January 1, 2004, deadline for the centralized system until January 1, 2006, an initial attempt to implement it was unsuccessful in 2002.

In January 2003, SBE in conjunction with the Maryland Association of Election Officials, formed the Functional Requirements Committee for the purpose of drafting detailed requirements for a centralized voter registration system. The strategy of this committee was to develop a request for proposals (RFP) centered on an already developed, commercially available software product. This strategy was in response to the difficulties encountered during SBE's initial attempt to implement a centralized system that had involved a software product in its developmental stages, a circumstance that was a significant factor in the products' ultimate inability to fulfill the State board's and the local boards' requirements.

In May 2003, the committee released its *Statewide Voter Registration System Feasibility Study*, which included the results of a market analysis of existing vendors and products that concluded none of the surveyed vendors/products fully met the committee's requirements. On July 13, 2003, SBE released a detailed RFP for a "complete" centralized voter registration system. A review of the bids submitted by vendors after the early October 2003 RFP deadline resulted in a determination by SBE that an insufficient number of bids had been received prior to the deadline, thereby rendering the entire bidding process noncompetitive.

After having conferred with several vendors regarding their concerns about provisions in the initial RFP that might have discouraged more robust vendor participation, SBE plans to revise the RFP for resubmission in mid to late November 2004. Among the issues that particularly concerned vendors were some of the software certification requirements, liability language in the proposed contract, and a requirement that vendors' software be able to demonstrably handle a minimum of 450,000 records.

Federal Continuity of Government Legislation

In April 2004 the U.S. House of Representatives passed The Continuity in Representation Act of 2004 (H.R. 2844). This bill would have addressed the critical issue of how vacancies in the House of Representatives would be filled in the event that a substantial number of representatives are killed by a catastrophic event. Specifically, the bill would require states to conduct special elections within 45 days of an announcement by the Speaker of the House that the number of vacancies exceeds 100. The bill failed in the Senate.

In Maryland, State law requires the Governor to schedule special elections for a member of the U. S. House within 10 days after the date of a vacancy. In general, a special primary may not be held less than 36 days after the Governor's proclamation and a special general election is to be held not less than 36 days after a special primary. There is no maximum amount of time in statute within which a special election must be held after a vacancy occurs.

State Continuity of Government

A parallel issue to federal continuity of representation is the continuity of state legislative bodies. As on the national level, the potential of widespread vacancies in state legislative bodies pose many of the same challenges. Maryland is among 13 states that currently have no constitutional or statutory provisions providing for timely succession to legislative seats in the event of mass vacancies or incapacitation of members. Thirty-five states address continuity in their constitutions. Nine states have statutes addressing legislative continuity in the event of mass vacancies, and four states have continuity statutes covering all three governmental branches. In general, state level continuity provisions address issues related to:

- temporary appointments to office;
- emergency suspension of the rules;
- adjusted quorum requirements;
- alternative convening locations for legislatures; and
- selection of a temporary seat of government.

Maryland law requires the Governor to appoint an individual to a vacant seat in the General Assembly from a list of names provided by the predecessors' party central committee. The central committee has 30 days to submit a list of names after a vacancy occurs, and the Governor must make an appointment within 15 days of receiving the list.

For further information contact: Michelle Davis/Daneen Banks Phone: (410) 946/(301) 970-5510

State Government

Task Forces, Study Groups, and Special Legislative Committees

Various task forces and other entities have been established in recent years to study and make recommendations on issues and topics that are not otherwise covered in these issue papers.

Task Force to Study the Economic Development of the Maryland Seafood and Aquaculture Industries

Chapter 535 of 2002 established the Task Force to Study the Economic Development of the Maryland Seafood and Aquaculture Industries. The task force consists of a seafood industry workgroup and an aquaculture industry workgroup. The seafood workgroup was charged with reviewing the current methods of processing and marketing Maryland seafood and developing innovative methods to increase the demand for Maryland seafood both locally and nationally. The aquaculture workgroup was charged with examining the viability of different types of aquaculture in the State and developing methods to encourage and foster aquaculture. The task force was required to issue its final report by September 30, 2004; however, a request for an extension until mid-November was filed with the General Assembly. Although the final report was not available at the time of this writing, it is anticipated that the task force will propose legislation for consideration during the 2005 session.

Bay Restoration Fund Advisory Committee

The Bay Restoration Fund Advisory Committee was created by Chapter 428 of 2004, which also established the Bay Restoration Fund to reduce nutrient loading to the Chesapeake Bay by financing (1) nutrient removal upgrades for the State's wastewater treatment plants (WWTPs); (2) upgrades of septic systems; and (3) cover crop activities. The Act established a bay restoration fee to be paid by users of WWTPs and owners of septic systems and sewage holding tanks. Among other things, the committee is charged with (1) analyzing the cost of nutrient removal from WWTPs; (2) identifying additional funding sources for the fund; (3) making recommendations regarding the appropriate fee to be assessed in future years; and (4) in consultation with counties, identifying septic system and sewage holding tank users and making recommendations regarding the collection of the fee from those users that do not receive water bills.

In consultation with the governing body of each county, the committee also must study and report to specified committees of the General Assembly by January 15, 2005, regarding the methods evaluated and recommended for the collection of the fee by local governments from users of septic systems and sewage holding tanks that do not receive water bills. The advisory committee is subject to other reporting requirements in future years. As of early November, the advisory committee has held one meeting; the discussion at that meeting focused largely on fee collection methods. It is not anticipated that the committee will recommend any legislative changes for consideration during the 2005 session.

Universal Environmental Covenants Workgroup

Chapter 73 of 2004, the Brownfields Redevelopment Reform Act, required the Maryland Department of the Environment (MDE) to convene a workgroup to review the Universal Environmental Covenants Act proposed by the National Conference of Commissioners on Uniform State Laws. The workgroup includes representatives of the Maryland Department of Planning, the Department of Business and Economic Development, various sectors of local government, real estate professionals, the business community, the banking industry, and the environmental community. The workgroup held one meeting in late October and is expected to report its findings to the Governor and the General Assembly by December 31, 2004.

Electronic Waste Funding Workgroup

Chapter 154 of 2004 required MDE, in collaboration with various interest groups, to consider methods of funding and establishing a statewide electronic waste collection and recycling system. A workgroup assembled by MDE met several times over the interim. MDE solicited recommendations from all the members and is expected to report its recommendations for funding to the Governor and the General Assembly by December 31, 2004, and its recommendations for establishing and implementing a system by July 1, 2005.

Task Force to Study the Maryland Agricultural Land Preservation Foundation

Chapter 473 of 2002 reauthorized the task force to review and make recommendations on several issues related to the Maryland Agricultural Land Preservation Foundation. The task force issued an interim report prior to the 2003 session detailing a number of legislative recommendations and was required to issue a final report by June 1, 2004. The final report was delayed and was not available for review at the time of this publication. It is anticipated, however, that the final report will include a recommendation to increase funding for the program in order to hire additional staff and purchase additional easements. The final report will also likely recommend increasing the use of installment purchase agreements for easement purchases.

Advisory Committee on the Management and Protection of the State's Water Resources

The Advisory Committee on the Management and Protection of the State's Water Resources was created by executive order in January 2003 to evaluate the sustained ability of the State to meet its projected water needs. In its final report, issued in May 2004, the advisory committee made the following recommendations:

- continue the comprehensive evaluation of watersheds and aquifers that are significant sources of water supply and continue an advisory committee to provide guidance in implementing the recommendations;

- restore funding for existing observation wells and stream gauges and expand monitoring networks as funding becomes available;

- improve coordination between Maryland and Virginia regarding water allocations from the Potomac River;

- support water and sewer planning at the State and local government levels;

- implement a comprehensive outreach program to educate Maryland citizens and create partnerships for stewardship of the State's water resources;

- exempt withdrawals below a minimum threshold in the appropriation permit law; and

- review laws, regulations, funding resources, and State laboratory capacity relative to comprehensive management of the State's water resources.

MDE has developed an action plan for the implementation of the committee's recommendations. At least two of the items within its action plan involve legislative action. First, MDE is preparing draft legislation to streamline the water appropriation permit process for small users, either through an exemption, a general permit, or a registration process without a permit. Second, MDE is preparing draft legislation to establish administrative penalties for water appropriation permit violations. In addition, MDE is reviewing the laws, regulations, funding resources, and State laboratory capacity relative to management of the State's water resources; this process could lead to the development of additional legislation.

Task Force on the Status of Women and Information Technology

Chapters 489 and 490 of 2004 created a five-year 20-member Task Force on the Status of Women and Information Technology. The task force is charged with studying the declining involvement of girls and women in information technology (IT) and the impact of this decline on the future of the IT workforce in Maryland; examining existing programs, laws, and services to identify practices to address this issue; and developing a statewide women and IT plan as well as strategies for implementing and promoting the plan. An annual report to the Governor and the General Assembly is required. To date, however, the task force members have not been appointed.

Task Force on Lending Equity with Financial Institutions Providing State Depository Services

Chapters 114 and 115 of 2004 created a 15-member Task Force on Lending Equity with Financial Institutions Providing State Depository Services to identify data to demonstrate whether financial institutions provide adequate access to credit and capital for minority business enterprises; advise the Treasurer in developing additional criteria for selecting financial institutions as depositories; and develop a strategy to implement a lending equity policy. An interim report is due by December 1, 2004, and a final report by September 1, 2005. To date, however, the task force members have not been appointed.

Task Force to Study Criminal Offender Monitoring by Global Positioning Systems

Chapters 138 and 139 of 2004 created a Task Force to Study Criminal Offender Monitoring by Global Positioning Systems (GPS). The task force must study (1) how the State can utilize GPS technology to monitor certain individuals who have committed criminal offenses; (2) how law enforcement can benefit from linkage to such technology to solve crimes and streamline workload; (3) the feasibility of implementing a GPS technology program, including conducting a cost benefit analysis; and (4) admissibility of evidence and other relevant issues. The task force must submit an interim report to the Governor and the General Assembly by December 31, 2004, and a final report by December 31, 2005. The Department of Public Safety and Correctional Services is required to provide staffing to the task force. To date, members of the task force have not been appointed.

Task Force to Study the Dynamics of Elderly and Retiree Migration Into and Out of Maryland

Chapter 525 of 2004 established the Task Force to Study the Dynamics of Elderly and Retiree Migration Into and Out of Maryland. The task force is charged with reviewing the dynamics of elderly and retiree migration into and out of the State and assessing the impact of the tax policies and benefits of the State and other states on elderly and retiree migration. The task force is also required to examine the benefits that the elderly and retirees provide to the State and local communities and the costs to the State and county governments associated with the elderly and retirees, including health care expenditures.

The task force will oversee and help prepare a comprehensive study to be conducted by the Maryland Institute for Governmental Service, the Maryland Institute for Policy Analysis and Research (University of Maryland, Baltimore County), Loyola College, and the Regional Economic Studies Institute. A report to the Governor and the General Assembly detailing findings and recommendations is due by December 31, 2004. The task force held an initial meeting on October 21 and is expected to seek an extension of at least one year.

Task Force on Law Enforcement Officers' Pensions Exemption from Taxation

Chapter 534 of 2004 established a task force to study the issue of exempting specified State and local law enforcement officers from paying income taxes on their pensions. The officers include members of the State Police Retirement System, the Law Enforcement Officers' Pension System, the Local Fire and Police System, any local pension or retirement system for law enforcement officers, and parole and probation officers who are members of the Employees' Retirement System or the Employees' Pension System. The task force is required to study (1) the benefit that members would derive from an exemption; (2) the impact on State revenues and the ongoing structural budget deficit; (3) the impact on the State Retirement and Pension System; and (4) the administrative and legal changes necessary to implement such an exemption. The task force, staffed by the State Retirement Agency, is meeting over the interim and is expected to report its recommendations to the Governor and the General Assembly by December 31, 2004.

Task Force on Missing Vulnerable Adults

Chapter 528 of 2004 established the Task Force on Missing Vulnerable Adults to recommend ways of establishing a system to locate and identify vulnerable adults who are missing, recommend protocols for law enforcement officials when working with broadcast media in such cases, and investigate possible integration with the Amber Alert plan for child abductions. Maryland releases information to the public on serious child abductions through the Amber Alert plan, a voluntary partnership between law enforcement agencies and broadcasters coordinated by the State Police. The State does not have a statewide plan to address the problem of locating vulnerable adults who are reported missing. The task force, staffed by the State Police, is required to report its findings to the General Assembly by October 1, 2005. It is scheduled to begin meeting in December 2004.

Task Force on Parking for Individuals with Disabilities

Chapter 268 of 2004 established a task force to study current laws regarding parking privileges for individuals with disabilities and to make specific recommendations on issues relating to parking placards, plates, and parking spaces for individuals with disabilities. Initial meetings have focused on federal disability parking legislation, the Maryland Motor Vehicle

Administration's process for obtaining parking placards and plates, medical eligibility criteria for obtaining parking placards and plates, parking space allocation and signage, enforcement, and possible recommendations to address these issues. The task force must report its findings and recommendations to the General Assembly by December 31, 2004.

Task Force on Business Owner Compensation in Condemnation Proceedings

Chapter 446 of 2004 established the Task Force on Business Owner Compensation in Condemnation Proceedings to study the concept of business goodwill, with a particular focus on small business goodwill, and the appropriateness of developing a method for determining the value of such goodwill for purposes of calculating compensation in condemnation proceedings. The task force is looking at the feasibility of requiring each displacing public agency to conduct a study of the impact of condemnation on businesses in the proposed area where condemnation proceedings will take place. The task force is also examining the appropriateness of establishing a fund to provide financial assistance to businesses affected by condemnation, the feasibility of shortening the condemnation process, the appropriateness of making a legislative proposal applicable statewide or only in Baltimore City, and the circumstances under which condemnation can be used in the State. The task force is expected to conclude its work and report its findings by December 31, 2005.

Governor's Interagency Steering Committee for Managing for Results

Chapter 452 of 2004 codified the Managing for Results (MFR) process established by the Department of Budget and Management (DBM). The legislation established a number of requirements in addition to those already implemented by DBM, among them the requirement for a State Comprehensive Plan for MFR, documentation of internal controls used to evaluate performance measures, and an annual progress report by DBM to the budget committees in January.

The legislation also required the continuation of the internal MFR Steering Committee. The steering committee has complied with the requirement to invite the participation of three members from the Legislative Branch: one senator, one delegate, and one budget analyst from the Department of Legislative Services.

Members of the steering committee, primarily representatives of the larger State agencies, met a number of times from March to October 2004. Issues dealt with largely centered on the practical aspects of implementation of MFR and the requirements of Chapter 452. The steering committee is also required by July 1, 2006, in consultation with the Office of Legislative Audits, to report to the budget committees on the progress made in implementing, and the effectiveness of, the MFR process. The report is to include a comparative analysis of the State's Managing for Results process with performance budgeting in other states; the extent to which State agencies have implemented internal controls as provided for by the Department of Budget and Management's operating budget instructions; and the extent to which the managing for results process is used by State agencies and DBM in agency management, operations, and the development and adoption of agency budgets.

Task Force to Study Utilization Review of the Surgical Treatment of Morbid Obesity

Chapter 486 of 2004 created a Task Force to Study Utilization Review of the Surgical Treatment of Morbid Obesity. The task force was directed to examine utilization review procedures used by health insurance carriers, review National Institutes of Health (NIH) guidelines and any other national guidelines or criteria, and recommend a set of guidelines or criteria appropriate for the utilization review of the surgical treatment of morbid obesity and reasonable procedures for documenting patient compliance with the guidelines or criteria. The task force must report its findings and recommendations by December 1, 2004.

The draft report of the task force recommends:

- The mandated benefit for the surgical treatment of morbid obesity should continue to require carriers to include coverage for surgical treatment (bariatric surgery) that is recognized by NIH as effective for the long-term reversal of morbid obesity and consistent with guidelines approved by NIH.

- The Maryland Insurance Commissioner should promulgate regulations clarifying the applicability of NIH guidelines for carriers and private review agents.

- The commissioner's regulations should also set forth reasonable documentation requirements for the utilization review of bariatric surgery.

- Carriers, physicians, hospitals, and others should note the importance of a surgeon's training and a facility's readiness to treat obese patients as factors influencing patient outcomes in any educational material provided on bariatric surgery.

- The General Assembly should authorize the task force to convene on an annual basis for at least the next three years to review the current literature, make recommendations as appropriate regarding the mandated benefit for the surgical treatment of morbid obesity, and receive staff support from the Maryland Insurance Administration.

Task Force to Study Access to Mental Health Services

Chapter 224 of 2003 established a Task Force to Study Access to Mental Health Services. The task force was charged with studying and making recommendations regarding the mental health parity law, barriers and access to care for commercially insured individuals, differences in coverage between the public mental health system and commercial coverage, the structure and effectiveness of the State's mental health delivery system, and the cost of any recommended changes. The task force reported its preliminary findings to the Governor and the General Assembly in December 2003 and must issue a final report with findings and recommendations by December 31, 2004.

In many meetings and a public hearing, the task force heard that, although the public mental health system provides a far richer array of services than commercial coverage typically provides, budget cutbacks have restricted publicly-funded services primarily to Medicaid recipients. Commercial insurance benefits are usually limited to outpatient treatment, short inpatient stays, and partial hospitalization. As of November 2004, task force members remained divided on possible recommendations to address the barriers to care that currently exist.

Joint Legislative Committee to Study and Make Recommendations about Emergency Medical Response System

Chapter 385 of 2003 established this joint legislative committee to make recommendations on the structure and funding of the State's emergency medical response system. Initial meetings of the joint committee focused on understanding the current structure of the emergency medical response system. The joint committee is also assessing the plans to finance the impending replacement of 12 Maryland State Police helicopters and the possible incorporation of commercial air ambulances into the current Medevac system for interhospital transport and emergency medical on-scene response. The joint committee is expected to conclude its work and report its findings by December 1, 2004.

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Local Government

State Aid to Local Governments

State aid to local governments accounts for approximately 27 percent of total State expenditures (general and special funds) and 37 percent of State general fund expenditures. The rate of growth in State aid continues to exceed the rate for most State agencies due primarily to the increased funding for public schools required by the Thornton legislation.

State Aid Increases in Fiscal 2006

State aid to local governments is projected to total $5.3 billion in fiscal 2006, representing a $600.7 million or 12.8 percent increase over the prior year. Public schools will receive 80 percent of the projected increase in State aid, representing a $482.1 million increase in State funding. County and municipal governments account for 18 percent of the projected State aid increase, representing a $106.3 million funding increase. State aid to local health departments, libraries, and community colleges will receive modest aid increases in fiscal 2006. The projected increase in State aid for fiscal 2006 is significantly higher than the growth rate in prior years. For comparison purposes, State aid increased by 6.1 percent in fiscal 2003, 2.5 percent in fiscal 2004, and 11.1 percent in fiscal 2005. Since fiscal 1996, State aid has increased at an average annual rate of 6.6 percent. **Exhibit 1** shows the change in State aid by governmental entity, and **Exhibit 2** shows the change in State aid by major aid programs.

Exhibit 1
State Aid to Local Governments – By Governmental Entity
($ in Millions)

Governmental Entity	FY 2005	FY 2006	Difference	% Change
Public Schools	$3,633.7	$4,115.8	$482.1	13.3%
County/Municipal	758.2	864.5	106.3	14.0%
Community Colleges	184.0	193.5	9.5	5.2%
Local Health	60.9	63.1	2.2	3.6%
Libraries	50.4	50.9	0.5	1.1%
Total	**$4,687.1**	**$5,287.8**	**$600.7**	**12.8%**
General Funds	$4,216.4	$4,634.6	$418.2	9.9%
Special Funds	$469.1	$651.6	$182.4	38.9%
GO Bonds	$1.6	$1.6	$0.0	0.0%

Source: Department of Legislative Services

Exhibit 2
State Aid to Local Governments – Major Programs
($ in Millions)

	FY 2005	FY 2006	Difference	% Change
Public Schools				
Foundation	$2,114.6	$2,322.1	$207.5	9.8%
Compensatory Aid	487.5	598.1	110.6	22.7%
Limited English Proficiency	51.3	67.1	15.7	30.6%
Student Transportation	175.5	185.2	9.7	5.5%
Special Education – Formula	157.2	191.7	34.5	21.9%
Special Education – Nonpublic	108.8	133.9	25.1	23.1%
Guaranteed Tax Base	19.1	38.8	19.7	102.8%
Geographic Cost Index	0.0	54.2	54.2	
County/Municipal				
Highway User Revenues	426.6	548.0	121.4	28.4%
Disparity Grants	93.1	96.6	3.5	3.7%
Police Aid	62.4	63.7	1.3	2.1%
Electric Utility Tax Credit	30.6	30.6	0.0	0.0%
Program Open Space	15.0	76.1	61.1	407.2%
Community Colleges				
Cade Formula	146.6	154.1	7.6	5.2%
Local Health Departments				
Local Health Formula	60.9	63.1	2.2	3.6%
Libraries				
Library Formula Aid	27.8	28.1	0.3	1.1%
State Library Network	14.2	14.3	0.1	1.2%

Source: Department of Legislative Services

Public School Funding Accounts for Most of the State Aid Increase

Funding for public schools accounts for most of the increase in State aid (80 percent) in fiscal 2006, when public schools will receive $4.1 billion, representing a $482.1 million or 13.3 percent increase over the prior year. The anticipated increase in State aid reflects the continuing implementation of Chapter 288 of 2002, commonly referred to as the Thornton legislation. Chapter 288 enhances per pupil State aid through the foundation program, enhances per pupil funding for three special needs populations, provides incentives to low wealth counties to contribute more than the minimum required funding, and phases out certain education programs over a five-year period.

County and Municipal Governments Will Realize Increased State Support

County and municipal governments are projected to receive $864.5 million in fiscal 2006, representing a $106.3 million or 14.0 percent increase. The largest increase occurs in local highway user revenue which is projected to total $548.0 million, a $121.4 million increase over the fiscal 2005 legislative appropriation. This estimate assumes that local highway user revenues will not be transferred to the State's general fund to close the anticipated budgetary shortfall. In both fiscal 2004 and 2005, $102 million in local highway user revenues were transferred to the State's general fund. In addition, funding for Program Open Space has been restored in fiscal 2006 and is projected to total $76.1 million, a $61.1 million increase from fiscal 2005. For the last several years, a portion of State transfer tax revenue that is used to fund Program Open Space has been transferred to the State's general fund. Funding for disparity grants is projected to increase by $3.5 million in fiscal 2006, and police aid is projected to increase by $1.3 million. Most other grant programs are projected to be level funded in fiscal 2006.

Modest Increases in Community College, Library, and Health Funding

State aid to local community colleges, libraries, and local health departments is projected to experience modest growth in fiscal 2006. Funding under the Community College Cade formula is projected to increase by 5.2 percent to $154.1 million in fiscal 2006. This reflects a 1.9 percent increase in student enrollment and a 4.0 percent increase in the per pupil funding level. The library aid formula will total $28.1 million in fiscal 2006, representing a 1.1 percent increase over the prior year, resulting from annual population growth. Funding for the State library network will total $14.3 million. Local health grants are projected to total $63.1 million in fiscal 2006 which reflect $54.6 million in formula aid and $8.5 million in annualized salary adjustments.

State Paid Retirement Costs Increase

Retirement payments for teachers, librarians, and community college faculty will total $432.7 million in fiscal 2006 reflecting a $3.5 million, or 0.8 percent, increase. This increase reflects a slightly higher salary base for fiscal 2006. Retirement costs for fiscal 2006 are based on a $4.6 billion payroll and a 9.35 percent retirement contribution rate.

For further information contact: Hiram L. Burch Phone: (410) 946/(301) 970-5510

Local Government

Local Tax and Salary Actions

Local jurisdictions made several changes to their tax rates in fiscal 2005, affecting property, income, recordation, and hotel/motel taxes. In addition, most jurisdictions provided salary enhancements to their employees in fiscal 2005.

Local Government Tax Rates

Fifteen jurisdictions made changes to their local taxes and fees in fiscal 2005, with nine jurisdictions increasing local taxes/fees, four jurisdictions reducing them, and two jurisdictions raising and lowering them. Fewer jurisdictions increased taxes in fiscal 2005 than in fiscal 2004. Local tax rates were increased in 13 jurisdictions in fiscal 2004, with six counties increasing two or more taxes. **Exhibit 1** shows the number of counties changing their local tax rates in fiscal 2005. **Exhibit 2** is a comparison of local tax rates for fiscal 2004 and 2005.

Exhibit 1
Number of Counties Changing Local Tax Rates
Fiscal 2001 – 2005

	FY 2001		FY 2002		FY 2003		FY 2004		FY 2005	
	▲	▼	▲	▼	▲	▼	▲	▼	▲	▼
Property	9	2	5	3	1	5	4	1	2	6
Income	7	1	4	0	0	0	6	0	1	1
Recordation	1	0	1	0	2	0	5	0	1	0
Transfer	0	0	0	0	0	0	1	1	0	0
Admissions/Amusement	2	0	0	0	1	0	2	0	0	0
Hotel/Motel	3	0	0	0	0	0	1	0	5	0

Note: ▲ represents tax rate increase. ▼ represents tax rate decrease.
Source: Department of Legislative Services Annual Tax Survey

Property Tax Rates

For fiscal 2005, two counties, Allegany and Charles, raised their real property tax rates, while six counties – Anne Arundel, Montgomery, Queen Anne's, St. Mary's, Talbot, and Wicomico – lowered their real property tax rates. Real property tax rates range from $0.54 per $100 of assessed value in Talbot County to $2.328 per $100 of assessed value in Baltimore City.

Exhibit 2
Local Tax Rates – Fiscal 2004 and 2005

	Real Property		Income		Recordation		Transfer		Admissions & Amusement		Hotel/Motel	
County	**FY 2004**	**FY 2005**	**CY 2004**	**CY 2005**	**FY 2004**	**FY 2005**	**FY 2004**	**FY 2005**	**FY 2004**	**FY 2005**	**FY 2004**	**FY 2005**
Allegany	$1.0000	$1.0007	2.93%	2.93%	3.00	3.00	0.2%	0.2%	7.5%	7.5%	5.0%	8.0%
Anne Arundel	0.9550	0.9410	2.56%	2.56%	3.50	3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.3280	2.3280	3.05%	3.05%	2.75	5.00	1.5%	1.5%	10.0%	10.0%	7.5%	7.5%
Baltimore	1.1150	1.1150	2.83%	2.83%	2.50	2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	0.8920	0.8920	2.80%	2.80%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Caroline	0.9520	0.9520	2.63%	2.63%	5.00	5.00	0.5%	0.5%	0.0%	0.0%	0.0%	5.0%
Carroll	1.0480	1.0480	3.05%	3.05%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	0.0%	0.0%
Cecil	0.9800	0.9800	2.80%	2.80%	3.30	3.30	0.0%	0.0%	6.0%	6.0%	5.0%	5.0%
Charles	1.0160	1.0260	2.90%	2.90%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.9300	0.9300	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.0000	1.0000	2.96%	2.96%	5.00	5.00	0.0%	0.0%	5.0%	5.0%	0.0%	3.0%
Garrett	1.0360	1.0360	2.65%	2.65%	3.50	3.50	1.0%	1.0%	4.5%	4.5%	4.0%	4.0%
Harford	1.0920	1.0920	3.06%	3.06%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	0.0%	0.0%
Howard	1.1695	1.1695	3.20%	3.20%	2.50	2.50	1.0%	1.0%	7.5%	7.5%	5.0%	5.0%
Kent	1.0120	1.0120	2.58%	2.85%	3.30	3.30	0.5%	0.5%	4.5%	4.5%	3.0%	3.0%
Montgomery	1.0190	1.0090	3.20%	3.20%	3.45	3.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.3190	1.3190	3.20%	3.20%	2.20	2.20	1.4%	1.4%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	0.9760	0.9260	2.85%	2.85%	3.30	3.30	0.5%	0.5%	5.0%	5.0%	3.0%	3.0%
St. Mary's	0.9080	0.8780	3.10%	3.05%	4.00	4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	1.0100	1.0100	3.15%	3.15%	3.30	3.30	0.0%	0.0%	4.0%	4.0%	3.0%	5.0%
Talbot	0.5530	0.5400	2.25%	2.25%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	3.0%	4.0%
Washington	0.9480	0.9480	2.80%	2.80%	3.80	3.80	0.5%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	1.0410	1.0250	3.10%	3.10%	3.50	3.50	0.0%	0.0%	6.0%	6.0%	4.0%	4.0%
Worcester	0.7300	0.7300	1.25%	1.25%	3.30	3.30	0.5%	0.5%	3.0%	3.0%	4.0%	4.0%

Notes: Real property tax is per $100 of assessed value. Income tax is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: Department of Legislative Services Annual Tax Survey

Local Income Tax Rates

Kent County was the only county to raise its local income tax rate for calendar 2005, from 2.58 to 2.85 percent. St. Mary's County, on the other hand, was the only county to reduce its local income tax rate for 2005, from 3.10 to 3.05 percent. The local income tax rates range from 1.25 percent in Worcester County to 3.20 percent in Howard, Montgomery, and Prince George's counties.

Recordation Tax Rates

Baltimore City was the only local jurisdiction to change its recordation tax rate for fiscal 2005 with the rate increasing from $2.75 to $5.00 per $500 of transaction. The range for the recordation tax rates is $2.20 in Prince George's County to $5.00 per $500 of transaction in seven jurisdictions – Baltimore City and Calvert, Caroline, Carroll, Charles, Dorchester, and Frederick counties.

Transfer Tax Rates

No counties changed their transfer tax rate for fiscal 2005. Currently, 16 counties and Baltimore City impose a transfer tax. Local transfer tax rates range from 0.2 percent in Allegany County to 1.5 percent in both Baltimore City and Baltimore County. Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico counties do not impose a transfer tax.

Admissions and Amusement Tax Rates

No counties changed their admission/amusement tax for fiscal 2005. Admissions and amusement tax rates range from 0.5 percent in Dorchester County to 10.0 percent in seven jurisdictions – Baltimore City and Anne Arundel, Baltimore, Calvert, Carroll, Charles, and Prince George's counties. Caroline County is the only jurisdiction that does not impose an admissions and amusement tax.

Hotel and Motel Tax Rates

For fiscal 2005, five counties raised their hotel and motel tax rates – Allegany, Caroline, Frederick, Somerset, and Talbot. Two counties, Caroline and Frederick, implemented hotel and motel tax rates for fiscal 2005. Hotel and motel tax rates range from 3.0 percent in Frederick, Kent, and Queen Anne's counties to 8.0 percent in Allegany and Baltimore counties. Carroll and Harford counties do not impose a hotel or motel tax.

Other Local Tax Rates

Baltimore City raised its energy and telecommunications taxes, while Montgomery County increased its energy and transit tax rates. Caroline County increased its cable franchise tax rate, and Baltimore, Frederick, and Prince George's counties increased their 911 fee.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5 percent or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation can be overridden by an affirmative vote of seven of the nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2 percent or the increase in the consumer price index.

County Salary Actions

An analysis of local government salary actions for county employees and teachers indicates that most of Maryland jurisdictions are providing salary enhancements during improving economic times. **Exhibit 3** shows local salary actions for fiscal 2005. Twenty-one county governments provided their employees with a cost-of-living adjustment (COLA), while 20 counties provided step increases. Additionally, 21 boards of education provided COLAs for their teachers, and 22 provided step increases.

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Exhibit 3
Local Government Salary Actions in Fiscal 2005

	County Government		Board of Education (Teachers)	
County	**COLA**	**Step**	**COLA**	**Step**
Allegany	2.50%	No	4.00%	Yes
Anne Arundel[1]	2.00%	Yes	3.00%	Yes
Baltimore City[2]	Varies	Varies	0.00%	Yes
Baltimore[3]	2.25%	Yes	4.00%	Yes
Calvert[4]	2.00%	Yes	N/A	Yes
Caroline	4.00%	Yes	4.00%	Yes
Carroll	2.10%	Yes	2.00%	Yes
Cecil	0.00%	Yes	4.00%	Yes
Charles	2.00%	Yes	3.00%	Yes
Dorchester[4]	$752	Yes	N/A	N/A
Frederick[5]	1.50%	No	2.00%	No
Garrett	2.00%	Yes	4.00%	Yes
Harford	1.00%	Yes	2.00%	Yes
Howard	3.00%	Yes	6.00%	Yes
Kent	$500	Yes	2.00%	Yes
Montgomery[6]	2.00%	Yes	2.00%	Yes
Prince George's[7]	1.50%	Yes	3.00%	Yes
Queen Anne's[8]	2.00%	Yes	2.75%	Yes
St. Mary's[9]	2.50%	Yes	3.70%	Yes
Somerset	0.00%	Yes	2.00%	Yes
Talbot	0.00%	Yes	1.00%	Yes
Washington	3.00%	No	3.50%	Yes
Wicomico	3.00%	No	4.00%	Yes
Worcester	2.00%	Yes	2.00%	Yes
Number Granting	21	20	21	22

Source: Department of Legislative Services

Comments

[1] In Anne Arundel County, police officers received a 3% COLA, everyone else received a 2% COLA.

[2] In Baltimore City, firefighters received a flat 3% raise with no step increase. CUB (City Union of Baltimore) received a 2% COLA and a step increase. County managerial employees received neither a raise nor a step increase. Salary actions for the police department and other employee unions have yet to be decided.

[3] In Baltimore County, firefighters received a $2,300 COLA, police officers received a $2,500 COLA, and all other county employees received a 2.25% COLA.

[4] In Calvert and Dorchester counties, salary action for teachers for fiscal 2005 remain in arbitration. Calvert County school administrators received a 3% COLA.

[5] In Frederick County, the COLA also included a $200 adjustment for part-time employees and a $400 adjustment for full-time employees. In addition, no step increase was issued by the board of education; however, a new pay scale was implemented with revised step placement.

[6] In Montgomery County, firefighters received a 3.5% COLA, fire management received a 7% COLA, and all other county government employees received a 2% COLA.

[7] In Prince George's County, general salary schedule employees received a COLA of 1.5%. A 2% COLA was issued for police officers, firefighters, and correctional officers.

[8] In Queen Anne's County, teachers received a 2.75% COLA, and school administrators received a 4.29% COLA.

[9] In St. Mary's County, for both teachers and school administration, the COLAs were 3.5% for 12-month employees, 3.6% for 11-month employees, 3.7% for 10-month employees, and 3% for classified positions.

Local Government

Property Taxation in Maryland

Property assessments have soared in Maryland since calendar 2001 with the average three-year assessment increase totaling 16 percent in 2002, 26 percent in 2003, and 36 percent in 2004. The continual increase in property assessments throughout Maryland has resulted in periodic legislation to address property tax issues.

Importance of the Property Tax

Property tax collections in Maryland totaled $4.8 billion in fiscal 2003. The property tax is one of the three major revenue sources for county governments accounting for 25 percent of total revenues and the second largest revenue source for municipalities accounting for 30 percent of total revenue. The property tax remains a relatively stable and predictable revenue source, especially in periods of slow economic growth. Throughout the early 1990s, property assessments realized significant growth while other local revenue sources were realizing lower growth due to the slow down in the State's economy. Likewise, property assessments increased rapidly beginning in calendar 2001; whereas other local tax revenues, particularly income tax revenues, remained stagnant.

State Role in Property Assessments

There is a well-defined statutory relationship between the State and local governments in the administration of the property tax system in Maryland. While property tax revenues are a relatively minor revenue source to the State, the State has assumed responsibility for the valuation and assessment of property. Local governments, on the other hand, levy and collect property taxes. The State takeover of the valuation and assessment function was implemented to provide uniform and equitable assessments of property throughout the State. During the 1960s, legal challenges to the assessment process and growing concerns about sporadic reassessments mounted. A class action suit was brought by property owners from several counties charging that properties were not being reassessed uniformly. To address these concerns, legislation was enacted in 1973 that required the State Department of Assessments and Taxation to assume full cost and supervision of the property assessment function. The State assumption of the assessment function was phased in over three years.

Triennial Assessment Process

Real property is valued and assessed once every three years with assessors physically inspecting each property. No adjustments are made in the interim, except in certain cases. Any increase in property values is phased in over a three-year period; however, any decrease is recognized immediately for assessment purposes. Because only one-third of the properties in each county are reassessed in a given year, local governments can rely on prior years' growth in the other two-thirds of the base to reduce the full impact of any one-year decline in assessable base. Conversely, when market values are rising, assessed values lag behind the current market, resulting in a slower annual growth in the assessable base than the market may indicate. The triennial process and its three-year phase-in schedule provide some cushion for taxpayers during periods of dramatically increasing property values and for local governments during a downturn in the housing market.

Growth in Property Assessments

County assessable base has trended upward since the 1970s, with three primary patterns occurring over this period: strong assessment growth from fiscal 1970 to 1993 with average annual growth of 8.9 percent; slower assessment growth from fiscal 1994 to 2003 with average annual growth of 3.4 percent; and soaring assessment growth beginning in fiscal 2003 and projecting to continue into fiscal 2006 with average annual growth of 8.0 percent. The recent growth in the assessable base over the last three years is stronger than the high growth rate during the 1970s and 1980s taking into account the relatively low inflation rate over this period.

Property Tax Relief Measures

The constant increase in property assessments throughout Maryland has led the State, and in some instances the voters, to take action to curtail the rise in property taxes. There are three primary approaches used in Maryland to provide property tax relief to homeowners: (1) the homestead tax credit program which limits annual assessment increases to all homeowners regardless of income; (2) the homeowners' (circuit breaker) tax credit program and the renters' tax credit program which provide credits for certain individuals who qualify based on a sliding scale of property tax liability and income; and (3) property tax limitation measures that either limit the property tax rate that can be imposed by the county council or the property tax revenue that can be collected. All three of these approaches have significantly impacted either State or local revenues. Members of the General Assembly have repeatedly introduced legislation addressing these property tax relief measures.

Property Taxes in Surrounding States

Local governments in Maryland rely much less on property taxes than local governments in other states in this region, receiving approximately 57 percent of their tax revenue from property taxes compared to over 70 percent in surrounding states. Property tax revenue in New Jersey is essentially the only source of revenue for local governments, accounting for 98 percent of local tax revenue. There is also a heavy reliance on property taxes by local governments in Delaware, Pennsylvania, Virginia, and West Virginia. Property tax revenues consist of a quarter of the District of Columbia's total revenue.

Local Government

2005 Legislative Agenda – Maryland Municipal League

The Maryland Municipal League has identified three initiatives for its legislative agenda for the 2005 session: (1) protecting and restoring State assistance; (2) ensuring that public safety communications systems are cross-compatible among agencies and jurisdictions; and (3) allowing local jurisdictions to serve as an aggregator for the purchase of electricity.

Protecting and Restoring State Assistance

With an anticipated State budgetary shortfall of $311 million in fiscal 2006, the Maryland Municipal League (MML) will direct its resources to offset anticipated pressures to achieve a balanced budget by reducing State aid to local governments. Also, MML will attempt to restore State aid to local governments to levels that existed prior to the revenue reductions experienced by municipalities in fiscal 2004 and 2005.

Public Safety Communications

Local public safety agencies are under increasing pressure to provide citizens with enhanced levels of security at the State and local levels. Many public safety communication systems serving police, fire, and rescue service providers are not currently cross-compatible across agencies and jurisdictions. Outdated and aging equipment on all levels is a source of concern for all law enforcement agencies. As these agencies begin the process of replacing outdated equipment, MML believes that it is important that the replacement efforts be coordinated in such a manner that all public safety agencies are able to communicate effectively and efficiently. MML will seek out and support opportunities to secure State capital appropriations that provide assistance to municipalities in upgrading their communication systems to increase interoperability among State, county, and municipal public safety entities. The interoperability of public safety communication systems is currently available in Northern Virginia and was instrumental in responding to the terrorist attack at the Pentagon. Fire and emergency medical service agencies in Northern Virginia use the same equipment and are able to tune to each other's radio frequencies. This capability has been recognized by experts as being critical in responding to emergency situations that require a multijurisdiction response.

Electric Aggregation

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry, introducing "customer choice" of an electric supplier. Once the rate cap requirements negotiated with utilities expire in their service territories, wholesale power prices will determine the rates residential customers pay for electricity. As these rate cap requirements expire, residential electric customers will need a workable process to obtain competitive electric rates.

Aggregation, the combining of many small customers into a larger buying block, holds the potential to bring the benefits of competition to small consumers. MML contends that the only way aggregation will work to a resident's advantage is by allowing local jurisdictions to serve as default aggregators. However, the 1999 Act specifically forbids counties and municipal corporations from serving as aggregators for their residents unless the Public Service Commission determines that there is not sufficient competition within the boundaries of the county or municipal corporation.

According to MML, under default aggregation, after a local jurisdiction has passed a local ordinance allowing it to act as a default aggregator, it can use its competitive bidding process to select an energy supplier for its residents who have not chosen a competitive supplier or who have chosen an alternate supplier. MML advises that the local lawmaking process will ensure that all residents can voice their opinions on the decision. MML will thus seek legislation to allow a local jurisdiction to serve as an aggregator for its residents.

Local Government

2005 Legislative Agenda – Maryland Association of Counties

The Maryland Association of Counties has identified four initiatives for its legislative agenda for the 2005 session: (1) protecting State assistance; (2) increasing State funding for public school construction; (3) applying transfer and recordation taxes to real estate entity transfers of controlling interests; and (4) ensuring that public safety communications systems are cross-compatible among agencies and jurisdictions.

Protecting State Assistance

With State aid to local governments accounting for 27 percent of total State expenditures and the annual rate of growth in State aid reaching 13 percent, curtailing the growth in State aid may be one option to balance the State's budgetary shortfall in fiscal 2006. The State faces a substantial fiscal crisis, with current forecasts envisioning a general fund imbalance of $385 million in fiscal 2006 and $1.2 billion in fiscal 2007. In the last three fiscal years, State aid for local governments has been reduced from the statutory required funding level in order to balance the State budget. Where State assistance has been abridged, the Maryland Association of Counties (MACo) will support plans to reinstate assistance.

School Construction and Renovation Funding

The fiscal 2005 *Capital Improvement Program* (CIP) for State funding of public school construction shows State funding at $102.4 million per year for the next four years, which includes $100 million in general obligation bonds and $2.4 million in special funds. If the Governor continues to budget the same amount in fiscal 2006 and that amount is not increased by the General Assembly, funding for the State's School Construction Program will be at its lowest level in 10 years. Based on a 2003 survey by the Task Force to Study Public School Facilities, the cost to bring all schools up to standard is $3.85 billion.

Chapter 307 of 2004 states that it is the intent of the Governor and the General Assembly that a minimum of $3.85 billion be provided to fund school facility needs by fiscal 2013. Of this amount, the State will provide $2 billion, which is significantly higher than the current State commitment for public school construction, and local governments will provide $1.85 billion. The fiscal 2005 through 2009 CIP includes $501.6 million for the Public School Construction program. To meet this funding level by fiscal 2013, approximately $250.0 million in State funds would be needed annually, which is approximately $150.0 million more than the State's commitment for each of the next four fiscal years. MACo believes that additional legislation is needed to increase the level of State school construction funding.

Transfers of Controlling Interests

When individuals sell residential or commercial property, transfer and recordation taxes are paid on the value of that sale. However, a tax avoidance technique for commercial property involves the use of "single purpose entities" (most often a limited liability company) whose ownership or membership interest may be sold, without any new filing of land records and therefore no taxes collected. MACo believes that this inequity in tax collection forces residential and taxpaying commercial properties to subsidize public services on behalf of large commercial entities using controlling interest transfers. MACo will seek legislation that will apply transfer and recordation taxes to real estate entity transfers of controlling interests.

Connectivity and Interoperability of Public Safety Communications Systems

State and local public safety agencies seek to employ communications systems that effectively coordinate their efforts, both on an ongoing basis and during critical incidents. In many cases, however, these communications systems are dated and not cross-compatible among agencies and jurisdictions. MACo urges the State to partner with local jurisdictions implementing a system replacement or upgrade, so as to combine efforts to upgrade the State coverage in the same region and reduce costs to all parties. Through coordinated replacements, MACo maintains that the State/local partnerships will eventually yield a "backbone" sufficient to play host to a fully interoperable system of public safety communications, thus benefiting all agencies and the public they serve. Moreover, MACo urges the State to establish public safety interoperability as a priority for its homeland security distributions from the federal government. The interoperability of public safety communications systems is currently used by local governments in Northern Virginia and was instrumental in responding to the terrorist attack at the Pentagon. Fire and emergency medical service agencies in Northern Virginia use the same equipment and are able to tune to each other's radio frequencies. This capability has been recognized by experts as being critical in responding to emergency situations that require a multijurisdiction response.