Maryland General Assembly
Joint Committee on the Management of Public Funds

2011 Membership Roster

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THE MARYLAND GENERAL ASSEMBLY
ANNAPOLIS, MARYLAND 21401-1991

Joint Committee on the Management of Public Funds

December 21, 2011

The Honorable Thomas V. Mike Miller, Jr., Co-chair
The Honorable Michael E. Busch, Co-chair
Members of the Legislative Policy Committee

Ladies and Gentlemen:

The Joint Committee on the Management of Public Funds is pleased to present this report on its activities during the 2011 interim. The committee met three times, and the following provides a summary of each of the meetings.

July 12, 2011 Meeting

With four new members joining the committee this year, the first meeting focused on introducing committee members to the process for selling general obligation (GO) bonds and the organization of the State Treasurer's Office.

State Treasurer's Office

On July 12, 2011, State Treasurer Nancy K. Kopp, Chief Deputy Treasurer Bernadette T. Benik, and Director of Debt Management Patricia Konrad provided an overview of the process to sell GO bonds and the parties involved in a bond sale, such as the financial advisor, underwriters, and bond counsel. The briefing explained each of the steps involved in the process, from the authorization of the debt during the legislative session to post-issuance compliance requirements that last through the life of the bonds. Treasurer Kopp also provided an overview of the organization and duties of the office.

Treasurer Kopp reported that in late June, analysts from three credit rating agencies – Fitch Ratings, Moody's Investors Service, and Standard and Poor's – came to Maryland for a personal visit in advance of the July GO bond sale. Chairs Senator Jones-Rodwell and Delegate Gutierrez attended some of the sessions with the rating agencies. The Treasurer's Office reported that following this visit, the rating agencies maintained their AAA rating for Maryland.

The Treasurer noted two issues that may require action within the next year:

- **Prioritization of Debt Issuances:** Treasurer Kopp noted that one of the issues discussed during the 2011 legislative session regarded setting priorities for debt issuances. The State maintains debt affordability guidelines that measure the amount of debt service relative to revenues and personal income. Without further action, the State is expected to breach these guidelines within the next several years. Many types of debt fall under State debt affordability guidelines, including GO bonds, transportation bonds, bay restoration bonds, Stadium Authority bonds backed by State revenues, and certain capital leases. The Department of Legislative Services recommended during the 2011 session that each type of State debt should be annually authorized, allowing the remaining State debt capacity to be prioritized between different types of debt. Treasurer Kopp briefed the committee on this issue and the options available and recommended that prioritizing the use of State debt may be more appropriately done by the legislature rather than her office or the Capital Debt Affordability Committee.

- **Debt Service for GO Bonds will Soon Exceed Available Property Tax Revenues:** State property tax revenues are dedicated to the repayment of the State's GO bonds. In recent years, property tax revenues and bond premiums have been sufficient to pay GO bond debt service; however, beginning in fiscal 2013, revenues will be insufficient to pay debt service. There are several options to address this: (1) reduce expected bond issuances; (2) raise the property tax level; (3) use general funds to supplement property tax revenues to pay debt service; or (4) any combination of these options. Even if the State were to reduce expected bond issuances, this could help in the out years, but would have little effect on the shortfall in fiscal 2013. The use of general funds to pay debt service is also not ideal. The current fiscal climate limits the amount of general funds available in fiscal 2013 and beyond and the increasing amount that would be required over the next few years would make the use of general funds even more challenging. The Treasurer noted that this is an important issue that will require action.

Conclusions and Recommendations: The committee commends the Treasurer's Office for all of its hard work and recognizes that some difficult decisions will need to be made over the next year as the State approaches its debt affordability guidelines and debt service begins to exceed property tax revenues. The committee will continue to monitor these issues.

November 1, 2011 Meeting

On November 1, 2011, the committee was briefed on the findings and recommendations of the Public Employees' and Retirees' Benefit Sustainability Commission and by the Office of Legislative Audits on the annual review of local government audits.

Findings and Recommendations of the Public Employees' and Retirees' Benefit Sustainability Commission

Former Speaker of the House and Chairman of the Public Employees' and Retirees' Benefit Sustainability Commission, Casper Taylor, updated the committee on the work of his commission. The commission was created by Chapter 484 of 2010 to study and make recommendations on the State-funded health care benefits and pensions provided to State and public education employees and retirees. The commission issued its final report in January 2011 and sent a follow-up letter in July 2011 commenting on actions taken during the 2011 legislative session on the commission's recommendations.

During the 2011 legislative session, the Administration proposed changes to State pensions and employee and retiree health care. These changes were modified and adopted by the General Assembly. The changes address two key issues facing benefits: affordability, which is the ability of the State budget to support benefit costs; and sustainability, which is the long-term funded status of the benefits. In total, the pension reform changes adopted will allow the pension system to achieve 80% of actuarial funding within 10 years. Although the changes reduced the State's short- and long-term pension and retiree health care costs, the commission is concerned that additional changes may still be needed. The commission's unresolved recommendations are noted below.

- **Local Cost Sharing of Pension Benefits:** The commission recommended that teacher retirement costs should be shared with local boards of education so that, after a phased-in implementation, the State would pay no more than 50% of the combined costs of Social Security and pensions for teachers. Mr. Taylor stressed that the entity that sets salaries should be the one responsible for paying the associated pension costs. Hence, if pension costs are not shared with the local boards of education, then the alternative would be to shift responsibility for setting teacher salaries to the State.

- **Hybrid Benefit System for New Members:** The commission noted that changing attitudes toward retirement benefits among younger workers may make alternative pension options attractive. The added benefits for the State will be increased predictably and sustainability for pension costs. A hybrid pension system for new members could include elements of both defined-contribution and defined-benefits systems.

- **Transition Plan for Medicare-eligible Retirees:** During the 2011 legislative session, changes were made that require that all Medicare-eligible State retirees must join Medicare Part D for prescription drug benefits by 2020. The commission recommended that additional changes be made to the State's current retiree prescription plan so that it more closely mirrors the Medicare Part D plan.

- **Changes to Cost-of-living Adjustments for Current Employees and Retirees:** Legal questions remain about the ability of the State to make changes to the cost-of-living formula for time already earned by existing employees and retirees. The commission recommended that the issue should be examined further.

- **Develop an Alternative Funding Model for the Pension System:** The commission found that the State's current pension funding model, known as the "corridor method," is neither actuarially sound nor sustainable over the long term; however, it would be difficult to change in the current fiscal climate. The commission recommended that as economic conditions improve and pension liabilities are reduced, an alternative funding method should be developed that provides both adequate funding for the pension system and relatively stable contribution rates over the long term.

Conclusions and Recommendations: The committee commends the Public Employees' and Retirees' Benefit Sustainability Commission on its work. The committee recommends that the legislature continue to closely monitor and assess the performance of the State's pension and retirement systems and the short- and long-term cost of benefits provided to employees.

Briefing from the Office of Legislative Audits on its Review of Local Government Audits

Mr. Robert Garman from the Office of Legislative Audits (OLA) presented the following information on the desk reviews of local government audits for fiscal 2010. Out of 193 local government audit reports, 54 contained some type of noncompliance with generally accepted accounting principles and auditing standards. The number of local governments with areas of noncompliance remains relatively consistent over the last several years. The most significant and frequent problem areas for local governments include: failing to file an audit report or filing late and failing to present the audit or financial statements in accordance with generally accepted auditing and accounting principles. In addition, the review disclosed nine local governments with unsecured cash deposits and six local governments with general fund deficit balances.

One local government audit, for the Town of Fairmount Heights in Prince George's County, revealed findings that concerned the committee. Fairmount Heights has not yet filed its fiscal 2010 audit report and its fiscal 2009 audit report disclosed a general fund deficit. Furthermore, the auditor's report included an explanatory paragraph that stated that the town's delinquency in making certain payments raised substantial doubt about its ability to continue as a growing concern.

Committee staff noted that currently only five local jurisdictions have not yet submitted their fiscal 2010 audits, but all audits for fiscal 2009 and before have been received. If local jurisdictions fall more than two years behind in submission of their audits, the State can withhold State funding to the jurisdiction. Typically, a letter advising a local jurisdiction of this possibility is sufficient to get outstanding audit reports submitted.

Of more pressing concern to the committee was the audit findings related to the Town of Fairmount Heights. The fiscal 2010 audit has not yet been submitted, and the fiscal 2009 audit cited a general fund deficit of approximately $54,000. In fiscal 2009, revenues came in at less than half of what had been budgeted. In addition, the town is delinquent in payments to PEPCO, Prince George's County, and a lease for several police vehicles. Advice from the Attorney General's Office indicates that the State would not be legally obligated to pay any debts or deficits of local governments; yet, the implications of what actions the State could take if the financial situation worsened in Fairmount Heights or in another local jurisdiction are unclear.

Although not suggesting that bankruptcy by the Town of Fairmount Heights was imminent, committee staff researched provisions in federal and State law regarding municipal bankruptcies. The federal bankruptcy code allows municipalities to file for bankruptcy under Chapter 9; however, state approval is required. Although several states have municipal bankruptcy laws in place, either to allow or prohibit municipalities from entering into bankruptcy or to require certain intermediary steps like a state review of finances or receivership, Maryland law does not have any provisions on municipal bankruptcies.

Conclusions and Recommendations: The committee commends OLA for its thorough review of local government audit reports. The committee is concerned about the findings involving the Town of Fairmount Heights. The committee is also concerned that current law does not define the recourse the State has available if local jurisdictions have financial problems. Given recent news accounts of municipal bankruptcies and state receiverships or takeovers in local jurisdictions such as Harrisburg, Pennsylvania; Flint, Michigan; and Jefferson County, Alabama, the committee finds that additional research is needed on:

- ***what recourse other states have for local jurisdictions in financial trouble to prevent bankruptcy;***

- ***how other states address municipal bankruptcies; and***

- ***what provisions or safeguards Maryland may want to adopt.***

The committee will hold an early session briefing to start to look at these issues and will focus their attention next interim on this issue.

December 8, 2011 Meeting

At its December 8, 2011 committee meeting, the committee heard from the Comptroller of Maryland, the State Treasurer's Office, and staff from the Joint Legislative and Executive Commission on Oversight of Public-private Partnerships.

The Comptroller of Maryland

Comptroller Peter Franchot briefed the committee on the following activities of his office over the last year:

- **E-filing Use Remains Strong:** Nearly 2 million tax returns for tax year 2010 were filed electronically, comprising a majority of all tax returns filed electronically and marking an all-time high for the number of electronic submissions. Each electronic submission saves the State $1.60 and taxpayers can receive refunds deposited directly into their accounts within three days. The use of the State's free online filing services, including I-File for individuals and B-File for businesses, continues to grow as well.

- **Unclaimed Property Continues to be a Priority:** In fiscal 2010, the Comptroller's Office helped to resolve over 50,000 claims and returned nearly $44 million in unclaimed property to its rightful owners.

- **Financial Literacy in the Schools:** The Comptroller has undertaken efforts to require financial literacy as a graduation requirement in Maryland's high schools. The Comptroller has a petition with over 10,000 signatures of Marylanders who support this provision.

- **Fiscal Responsibility:** The Comptroller is working with vendors to encourage the use of electronic payments from the State. Electronic payments can save money by reducing costs for postage and envelopes.

- **Collection of Sales Tax for Online Purchases:** In 2010, Maryland lost an estimated $198.4 million in sales and use tax revenue from the sale of goods by online retailers. Generally, online retailers must have a bricks and mortar presence in the State in order for it to require the collection of sales tax. Over the last several years, attempts have been made at the federal level to allow states to collect sales tax revenues for online sales from retailers that do not have a presence in the state. In the absence of federal legislation, several states have addressed the issue independently, resulting in legal challenges. In a report issued in November 2011, the Comptroller advocated waiting for the federal government to act on this issue rather than for Maryland to try to act independently and face legal challenges.

Conclusions and Recommendations: The committee commends the Comptroller on his work on financial literacy, returning unclaimed property to its rightful owner, and cost-saving measures such as encouraging the use of electronic tax filing and electronic payments. The committee also encourages the Comptroller to continue to monitor issues relating to the collection of sales tax for online purchases.

Joint Legislative and Executive Commission on Oversight of Public-private Partnerships

The Joint Legislative and Executive Commission on Oversight of Public-private Partnerships was created by Chapters 640 and 641 of 2010 to study and make recommendations on the oversight of public-private partnerships. The commission is chaired by Lt. Governor Anthony G. Brown and staff from his office provided an update on the commission's work.

The commission heard from a number of industry experts about public-private partnerships and hosted a forum with over 200 participants to receive input from the public and interested stakeholders. The commission is working on its final recommendations and legislation is expected during the 2012 legislative session.

Committee members were very interested in the use of public-private partnerships for school construction. Staff from the Lt. Governor's office noted that Dr. David Lever, executive director of the Interagency Committee on School Construction, briefed the commission on school construction needs and stated that from fiscal 2013 through 2017, there are over \$3.0 billion in needs but funding is expected to total only \$1.3 billion. The Public School Facilities Act of 2004 (Chapters 306 and 307) established public-private partnerships as an acceptable alternative financing method for the construction of public schools and developed a process for their use. However, despite having an established process for using P3s for school construction and seeing many success stories for P3s for school construction in Virginia and Canada, few schools in Maryland have utilized this financing method.

Conclusions and Recommendations: The committee has been at the forefront of issues relating to public-private partnerships. In 2009, it began its work on the issue, and legislation creating the Joint Legislative and Executive Commission on Oversight of Public-private Partnerships was sponsored in the Senate by Chairman Jones-Rodwell based in part on the committee's work on the issue. Public-private partnerships can be an important tool in maintaining and improving the State's infrastructure; however, adequate oversight must be in place to ensure the State's interests are protected. The committee recommends that the Public-private Partnership Commission review the current statutory process for P3s for school construction, evaluate whether there are deficiencies in the current statute that prevent it from

being used more often, recommend changes to improve upon it, and examine other alternative financing techniques for school construction to help address the growing need.

The State Treasurer's Office

Chief Deputy Treasurer Bernadette T. Benik and Director of Debt Management of the Treasurer's Office, Patricia Konrad, provided an update on Maryland's credit ratings. Maryland is one of eight states with AAA ratings from all three rating agencies. In August 2011, Moody's Investors Service assigned a negative outlook to Maryland and four other states due to high levels of federal employment and federal procurement. The action followed assignment of a negative outlook to the debt of the United States. In December 2011, Moody's reviewed the federal exposure of each of the five states, including Maryland. As a result, outlooks for South Carolina and Tennessee were changed to stable, but outlooks for Maryland, Virginia, and New Mexico remained negative. In addition, the counties in Maryland rated AAA also have been given a negative outlook. Standard and Poor's did not change Maryland's outlook but did note the potential downside risk for Maryland's rating is significant reductions in federal funds that flow to the State. Both Moody's and Standard and Poor's will continue to monitor Maryland in light of actions taken at the federal level.

Conclusions and recommendations: The committee urged the Treasurer's Office to continue to educate the rating agencies about factors that mitigate the effect of high levels of federal employment and procurement in Maryland. These include the fact that part of the reason for the high levels of federal employment and procurement is simply a matter of proximity to the nation's capital. Moreover, many of the federal agencies and military bases located in Maryland, like Fort Meade and Aberdeen Proving Grounds, are nationally significant, and the likelihood of significant reductions in personnel or spending by those agencies is less than at other federal agencies and military bases.

Committee Sponsored Legislation

The committee voted to sponsor one piece of legislation for the Treasurer's Office during the 2012 legislative session. The legislation will allow State agencies that invest their own funds, like the Maryland Transportation Authority or Maryland Economic Development Corporation, to make investments in the Maryland Local Government Investment Fund. The Maryland Local Government Investment Fund allows local governments to pool their assets and gain access to higher yielding investments than they might have had access to if investing their funds separately and allows them to benefit from the investment expertise and resources offered by the manager of the pool. State agencies that manage their own investments often face similar problems. Without sufficient staff and resources to analyze investment opportunities, State agencies may resort to simple, short-term investment portfolios. In the current low interest rate environment, the returns earned on these portfolios are significantly lower than the returns being earned by investors in the Maryland Local Government Investment Fund. Therefore, this legislation will allow State agencies to access this fund as long as the agencies follow all of the same rules and oversight procedures to which local governments are subject.

Other Committee Activity During the 2012 Session

During the 2012 legislative session, the committee will hold an early session briefing to learn from experts in the field of municipal bankruptcies to understand how other states address this issue in statute. The committee will continue to examine this issue during the 2012 interim and expects to sponsor legislation in the 2013 legislative session to address municipal bankruptcy.

Respectfully submitted,

Senator Verna Jones-Rodwell
Senate Chair

Delegate Ana Sol Gutierrez
House Chair

VLJ:ASG/JDH/mpc

cc: Mr. Karl S. Aro
Ms. Lynne B. Porter
Mr. Warren G. Deschenaux