



# Capital Budget Overview

**By Delegate Susan L.M. Aumann**

The **Capital Budget** funds the construction of buildings and State infrastructure – known as *Capital Improvements*



# Qualifications to be considered a Capital Improvement Project:

There are two criteria that a project must meet in order to qualify as a capital improvement project:

- (1) a project must have a useful life greater than or equal to the life of the bonds sold to finance the project (Maryland's Constitution limits the length of state debt to 15 years)
- (2) the cost of the project must be at least \$100,000

# Criteria Limiting the Tax Supported Debt

- The Capital Debt Affordability Committee (CDAC) is required by state law to review the size and condition of all tax-supported debt to ensure that the State's supported debt remains affordable.
- The amount of debt outstanding has been determined in consultations with the rating agencies, investment bankers and financial advisors.
- In 2008 the CDAC report revised the State's debt limit from 3.2% to 4%. **The debt limit outstanding cannot exceed: 4.0% of personal income and the debt service cannot exceed 8.0% of State revenues.**

# Types of Tax-supported Debt

There are six types of tax supported debt issued by the State of Maryland:

## 1. General Obligation debt:

Backed by the full faith and credit of the State and have a limited maturity of 15 years. They provide funds for State owned capital improvements, higher education institutions, and locally owned public schools. (GO Bonds)

## 2. Maryland Department of Transportation:

Consolidated Transportation Bonds, notes and other obligations backed by the operating revenues and pledged taxes of the DOT; limited to 15 years. They are issued for highway and other transportation projects. These bonds are paid from the motor fuel tax, titling tax, sales tax on rental vehicles and a portion of the corporate tax, sales tax and use tax.

### 3. (GARVEE)Transportation Project Bonds:

Supported by anticipated federal highway aid (Grant Anticipation Revenue Vehicle) bonds issued by the Maryland Transportation Authority. Limited to 12 years. Debt service is paid using a portion of federal transportation funds.

#### 4. Leases and Conditional Purchase Financings:

Finances assets such as capital leases, energy leases and conditional purchase financing using Certificates of Participation (COPS).

COPS have been used in financing the Video Lottery Terminals, limited maturity to 5 years.

## 5. Maryland Stadium Authority Revenue Bonds:

Are secured by leases with the State for financing, acquisition and construction of professional sports facilities in Maryland. Lease rental payments are pledged to pay the debt service on the bonds.

Revenues from certain select lottery games are transferred to the Stadium Authority for operations and to cover lease payments.

## 6. Chesapeake Bay Restoration Bonds:

Secured by the revenue from a state wide fee and issued by the Maryland Water Quality Financing Administration for waste water treatment plants to remove nutrients loading into the Bay and its tributaries.

Supported by the “flush tax”

## Additionally:

There are various forms of non-tax supported debt that are issued by the State agencies and non-state public purpose entities.

*The largest types of tax supported debt are General Obligation bonds and Transportation bonds.*

# Capital Budget of 2012

## *General Obligation Bonds*

Year	Debt	Debt Service
2010	\$1,140,000,000 *	\$777,522,955
2011	\$ 925,000,000	\$841,983,644
2012	\$ 925,000,000	\$878,410,000

\* In September 2009, the Committee made a conditional recommendation of \$900 million for general obligation bond authorization by the 2010 General Assembly. In December, the committee revised the recommendation to \$1,140 million.

The history of projected authorizations is depicted in the following chart:

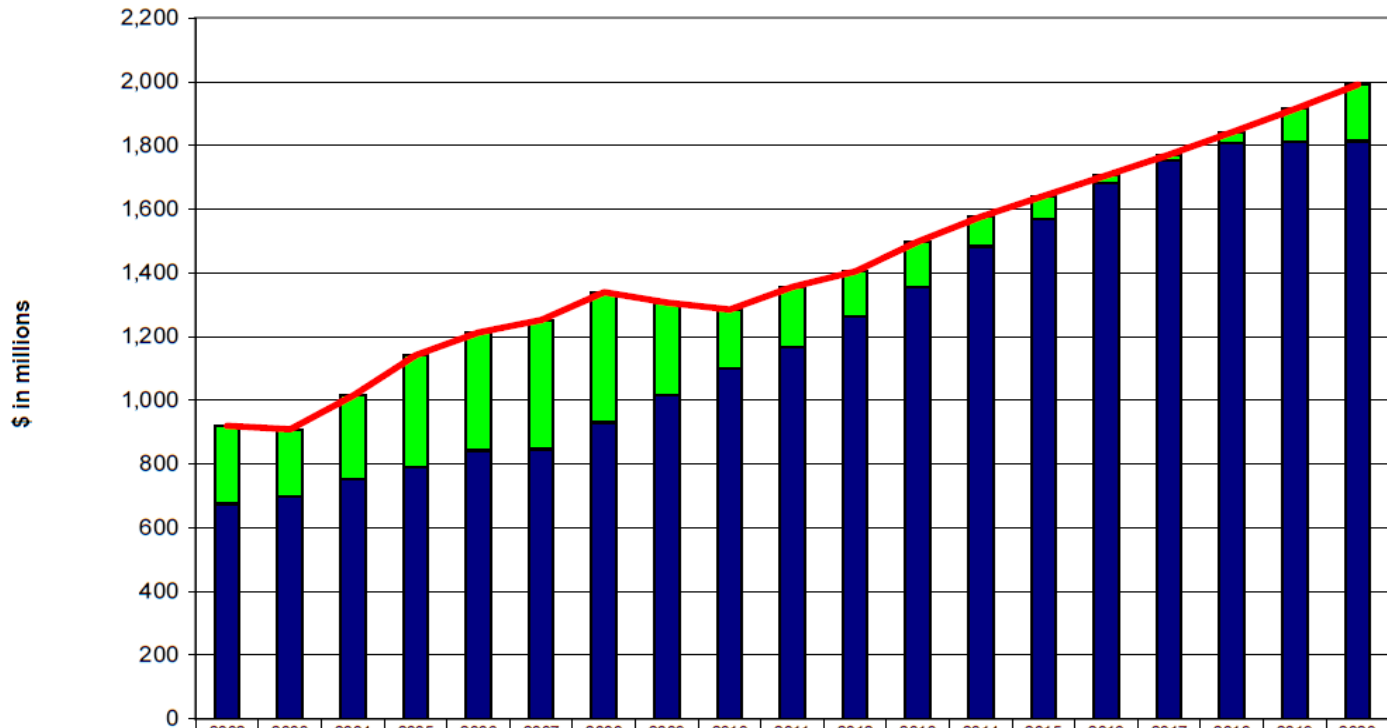
Projected General Assembly Authorizations in Fiscal Years:										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>CDAC Reports</b>										
2010	x	x	x	x	x	x	x	x	\$925	\$925
2009	x	x	x	x	x	x	x	\$1,140 <sup>1</sup>	\$1,020	\$1,050
2008	x	x	x	x	x	x	\$1,110	\$990	\$1,020	\$1,050
2007	x	x	x	x	x	\$935	\$960	\$990	\$1,020	\$1,050
2006	x	x	x	x	\$810	\$835	\$860	\$890	\$920	\$950
2005	x	x	x	\$690	\$710	\$730	\$745	\$770	\$795	\$820
2004	x	x	\$670	\$685	\$700	\$715	\$630	\$645	\$660	\$675
2003	x	\$650	\$665	\$680	\$695	\$710	\$630	\$645	\$660	\$675

Gray indicates those years where the increase in authorization from the prior year was approximately \$100 million or more.

# *Consolidated Transportation Bonds*

<b>Fiscal Year</b>	<b>Debt</b>	<b>Required Debt Service</b>
2010	\$1,795,000,000	\$155,000,000
2011	\$1,902,000,000	\$169,000,000
2012	\$2,154,000,000	\$197,000,000

**Available Debt Service Capacity Using the 8.0% Criterion  
as of SEPTEMBER 2010**



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Remaining Debt Service Capacity	245	210	263	351	371	406	409	292	184	191	143	143	94	73	23	18	36	105	177
Total Tax Supported Debt Service	674	699	751	790	842	846	929	1,015	1,100	1,165	1,261	1,355	1,482	1,568	1,682	1,754	1,805	1,810	1,813
8.0% Benchmark	919	909	1,014	1,141	1,212	1,252	1,339	1,307	1,284	1,356	1,405	1,498	1,576	1,642	1,706	1,771	1,841	1,915	1,991

Source: Table 2A as of Sept 2010

# ***The Capital Budget of 2012***

How does the State pay the interest and principle on most bonds that finance Capital Projects?

*The State depends on the state portion of the property tax. This is what is referred to as Debt Service, which is paid through the Annuity bond Fund.*

Tax supported debt consists of bonding through:

- General Obligations, or GO bonds
- Department of Transportation Consolidated Bonds
- Capital Leases
- Stadium Authority Bonds
- Bay Restoration Bonds, and
- GARVEE Bonds.

A new taxable series was introduced in 2011,

- Certificates of Participation (COP) to finance the video lottery terminals at Perryville and Ocean Downs. These instruments were structured instead of using the State's lease program. COPs are a method of structuring capital leases to attract multiple investors in a rated, public offering.

Although the Department of Budget and Managements has provided information regarding the GO Bonds and the debt service, that does not give the full picture of the total debt our State has on its books.

# Total tax supported debt outstanding\*:

Year	Debt	Debt Service
2010	\$ 9,385,779	\$1,100,158
2011	\$ 10,035,596	\$1,164,697
2012	\$ 10,801,780	\$1,261,321
2013	\$ 11,445,714	\$1,354,634

\*Information from the Treasures office Table 1 and 2A State Supported Debt Outstanding and Debt Service

# Annuity Bond Fund

- Debt service for the General Obligation Bonds is paid from the Annuity Bond Fund (ABF). The State constitution requires the collection of an annual tax to pay the debt service and State statute requires that after considering the balance in the ABF and other revenue sources. The Board of Public Works (BPW) sets an annual property tax rate sufficient to pay the debt service in the following fiscal year.
- According to the testimony submitted to the Appropriations committee by the State Treasurer on January 28, 2011, “The 2012 budget has sufficient revenues from the real property tax, federal interest subsidies on ARRA bonds, and bond premiums to meet the projected 2012 debt service”.

*However, beginning in fiscal year 2013, projections indicate that*

- *transfers from the General Fund*
- *or an increase in real property tax rates (or some Combination)*

**WILL BE NECESSARY to pay the**  
**State debt service**

# Future Projections

Specifically, current projections show shortfalls of:

\$132 million in 2012

\$258 million in 2013

\$310 million in 2014

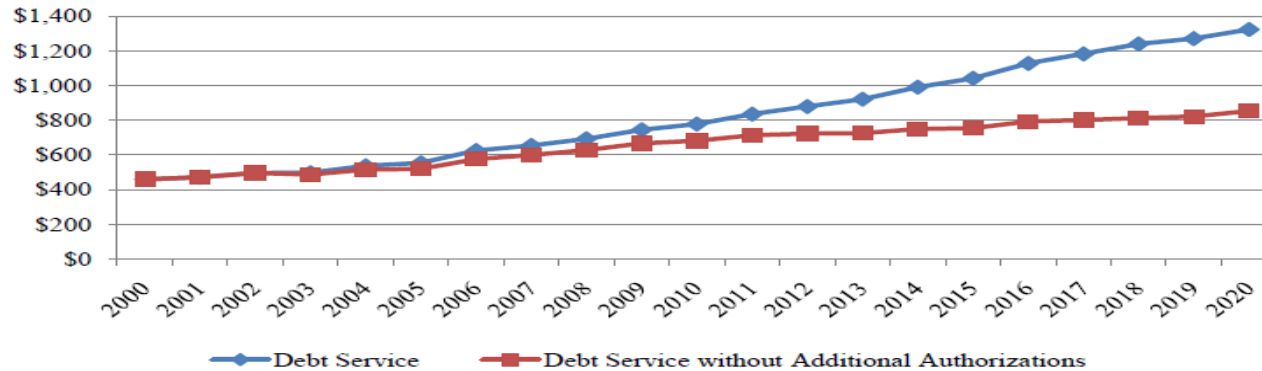
\$395 million in fiscal year 2015

From fiscal 2011 to 2015, debt service costs are estimated to increase by 5.5% annually while the state property tax revenues that support debt service are expected to decline.

### Debt Service Costs Increase in Response to New Authorizations

These increased authorizations result in higher debt service costs. DLS estimates that fiscal 2012 debt service costs would have been \$723 million without the additional authorizations, as shown in **Exhibit 7**. This is \$156 million less than the current projection, which totals \$878 million. From fiscal 2010 to 2020, debt service costs are projected to increase by 5.5% annually. Without the increased authorizations, the growth rate for GO bond debt service costs would have been 2.5% annually. By fiscal 2020, increased authorizations add \$470 million to debt service costs with debt service costs exceeding \$1.3 billion.

**Exhibit 7**  
**Effect of Increased GO Bond Authorizations on Debt Service Costs**  
**Fiscal 2000-2020**  
**(\$ in Millions)**



GO: general obligation

Source: Department of Legislative Services, January 2011

The out-year debt service estimates are consistent with the CDAC's new policy to reduce debt service costs. These new policies appear to have had some effect on debt service. For example, prior to the reduction in authorizations proposed in December 2009, the 10-year growth in debt service was projected to be 6.1%, which is 0.6% more than the current growth rate. Because of the nature of capital spending (primarily due to project funding that is authorized prior to planning and amortization schedules that do not retire principal in the first two years after bonds are issued), debt service will continue to increase at a high rate even after the State stops expanding capital spending.

# The Problem

The Treasurer and Legislative Services (DLS) realize that additional General Fund dollars must be used to supplement our current debt service levels. Instead of restraining the debt growth, the Treasurer and DLS recommend that the affordability limits may be breached. The pressure to pay the debt service is projected to rely on General funds in 2012. This is because we have extended more debt than what the property tax can support.

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# Consequences:

The State's portion of property taxes are supposed to pay the debt service. If the State does not place restrictions on the Capital Budget, debt service will have to be paid out of the General Fund.

The property tax was 8.4 cents per \$100 of assessed value for two decades.

The last time General Funds were used to pay for our debt service costs was in 2003.

In 2003, the rate had to be raised to 11.2 cents per \$100 of assessed value to pay the debt service.

Without restraint, the State will have to raise to the property tax to a higher level to relieve the demands on the General Fund estimated for fiscal 2013 and beyond.

Treasurer Kopp indicated that the property tax rate might have to increase to 17 cents per \$100 of assessed value to meet the current debt service costs.

**This will result in an increase of more than 50%**

# Pension Liabilities Affect:

- **Moody's Investors Service plans will include unfunded pension liabilities into its credit ratings for U.S. states' debt.**
- **In Maryland this new proposal will add \$16 billion of unfunded liabilities to our current debt levels.**

## Added Pressure:

If Maryland's unfunded pension obligations are factored into the State's debt capacity, our AAA bond rating will be in jeopardy.

# The Problem in Summary:

Maryland's credit card is maxed out!

DLS noted the following in the Treasurer's presentation to the Appropriations committee on January 28, 2011:

**Revised State Property Tax Revenues are projected to be insufficient to support debt service in the out years.**

# The Solution:

**Stop issuing excessive debt.**

**Stop Spending.**