Overview of Administration's Proposed Fiscal 2020 Budget Reductions

In accordance with Section 7-213 of the State Finance and Procurement Article, the Administration has provided notice of its intention to withdraw $120.7 million of general fund appropriations from the fiscal 2020 budget. These reductions will be considered by the Board of Public Works (BPW) at its next meeting planned for May 20, 2020. The Department of Legislative Services (DLS) has prepared this document to provide an overview and analysis of the proposed reductions.

Exhibit 1 provides a brief summary of the proposed actions, which include $97.0 million in reductions from the Dedicated Purpose Account (DPA) within the State Reserve Fund, $15.7 million in funding not currently allocated for specific pay-as-you-go (PAYGO) capital projects, and $8.0 million in unused tax credits.

Exhibit 1
Administration's Proposed Fiscal 2020 Reductions
($ in Millions)

Item	Reduction
Reserve Fund	
Washington Metropolitan Area Transit Authority Grant	$35.0
Bond Premiums Restricted for Debt Service	62.0
PAYGO	
Public School Safety Capital Grants	7.6
Community College Facilities Renewal Capital Grant Program	2.8
DHCD – Baltimore Regional Neighborhood Initiative	4.2
DHCD – Strategic Demolition Initiative	0.8
Hazardous Substance Clean-up Program	0.3
Tax Credits	
Historic Revitalization Tax Credit	7.0
Renters and Urban Enterprise Zone Tax Credit Program	1.0
Total General Fund Reductions	**$120.7**

DHCD: Department of Housing and Community Development
PAYGO: pay-as-you-go

Source: Department of Budget and Management

State Reserve Fund

Washington Metropolitan Area Transit Authority Capital Grant

The Administration's actions reduce $35 million in funding allocated to the DPA as a portion of the State's contribution to the Washington Metropolitan Area Transit Authority. Although the full $110 million amount appropriated for the dedicated capital grant was transferred to the Transportation Trust Fund (TTF) by budget amendment in October 2019, the Administration has submitted a revised amendment to reduce the transfer amount to $75 million. The Maryland Department of Transportation advises that the $35 million available for reduction was being withheld pending completion of an audit that will not conclude until after the current fiscal year ends.

It should be noted that it is unclear whether the funds transferred in the initial budget amendment are protected by provisions of the Maryland Constitution, which prohibit transfers from the TTF for nontransportation purposes except upon declaration by the Governor of a fiscal emergency, concurrence of the transfer by three-fifths of the members of each chamber of the Maryland General Assembly, and a requirement that the TTF be repaid within a certain period of time. The Department of Budget and Management argues that these funds transferred to the TTF are not TTF revenues and, therefore, not subject to the constitutional provision.

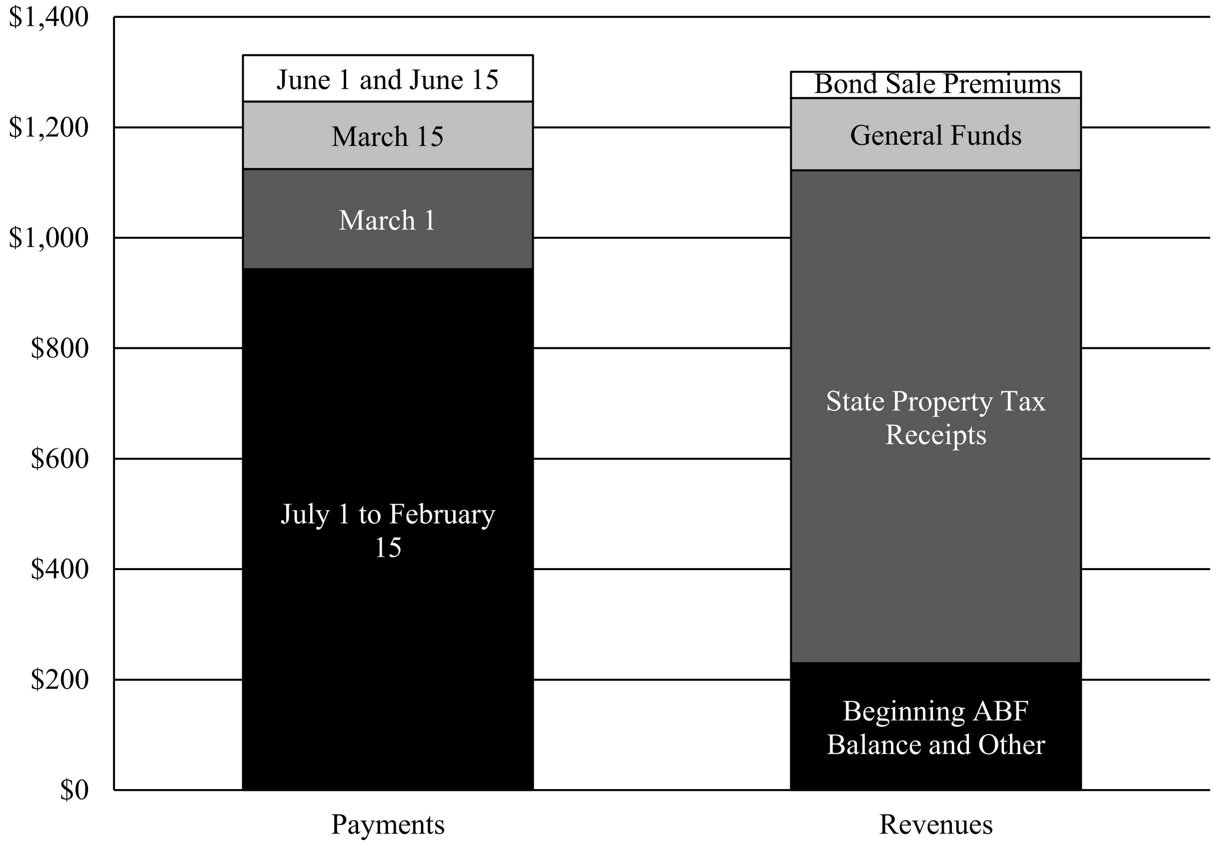
Reducing Funding Restricted by the General Assembly for General Obligation Bond Debt Service Costs

The Administration proposes to reduce a reserve fund appropriation by $62 million. These funds are restricted so that they can only be used to support general obligation (GO) bond debt service costs.

Fiscal 2021 GO bond debt service costs total $1,338 million. If the $62 million reduction is approved, revenues supporting GO bond debt service will total $1,300 million, which is $38 million less than debt service costs. The Administration anticipates that the remaining debt service costs will be supported by higher than budgeted bond sale premiums realized from two bond sales in fiscal 2021.

The State sells bonds in the summer, usually in August, and the winter, usually in March. Debt service payments are made throughout the year and are scheduled on the 1st and 15th of the month. **Exhibit 2** shows that debt service payments through March 15 total $1,254 million. This is less than the property tax revenues, general fund appropriations, Annuity Bond Fund balances, and other revenues after adjusting for the proposed BPW reduction. However, since these appropriations are sufficient to fund debt service until June, the State has until June 2021 to provide sufficient revenues for debt service. If the bond sale premiums are insufficient, there is time in March and April to fund debt service with a supplemental budget appropriation during the 2021 legislative session.

Exhibit 2
General Obligation Bond Revenues and Debt Service Payments
Fiscal 2021
($ in Millions)



ABF: Annuity Bond Fund

Note: Revenues exclude $62 million reduction. There are no debt service payments in April and May.

Source: Comptroller's Office; Department of Legislative Services

The capital budget (Chapter 537 of 2020) allocates $102 million of the first $149 million of bond premiums in fiscal 2021 to capital projects with the other $47 million funding fiscal 2021 debt service. To fund debt service costs, the fiscal 2021 bond sales will require $187 million in bond sale premiums. The Administration estimated in January 2020 that fiscal 2021 bond sale premiums would total $109 million, so the budget requires $78 million more than the Administration projected when preparing the budget.

The State anticipates issuing $1,075 million in bonds in fiscal 2021. The State has been regularly issuing $50 million to $100 million in taxable bonds in recent years to support projects that do not qualify as tax-exempt bonds. The taxable bonds are usually sold at par, so no premium is anticipated for these bonds. For this analysis, DLS estimates that $1 billion in tax-exempt bonds realizing premiums will be issued in fiscal 2021.The true interest cost was approximately 1.6% in the March 2020 bond sale. In recent years, coupon rates have ranged between 3.8% and 4.6%. DLS estimates that if interest rates remain low, anticipated premiums could range between $165 million and $255 million. **If investor behavior remains consistent and interest rates do not increase, it appears likely that the State will realize $187 million in premiums. However, if investor behavior changes or interest rates increase, the State may need to appropriate general funds in the 2021 legislative session to provide sufficient funding for the June 2021 debt service payments.**

PAYGO Capital

PAYGO capital programs are reduced by $15.8 million, consisting of the following:

- $7.6 million from the Public School Safety Grant Program that provides grants to local school systems for security improvements, including secure and lockable doors for every classroom, an area of safe refuge in every classroom, and surveillance and other security technology for school monitoring purposes. The proposed reduction would leave the program with $2.4 million of general funds from which to make grants in fiscal 2020.

- $5.0 million from the Department of Housing and Community Development, including $4.2 million from the Baltimore Regional Neighborhood Initiative (BRNI) Program, which provides grants to fund revitalization strategies in State-designated sustainable community areas in Anne Arundel and Baltimore counties and Baltimore City, and $775,000 from the Strategic Demolition Program. The Strategic Demolition Program assists with demolition, land assembly, housing development or redevelopment, and revitalization projects in sustainable communities throughout the State and is a central component of Project C.O.R.E. (Creating Opportunities for Renewal and Enterprise) established to remove blight in Baltimore City. The proposed reductions would leave $7.6 million to fund BRNI grants and $10.5 million for Strategic Demolition Fund activities in fiscal 2020.

- $2.8 million from the Community College Facilities Renewal Grant Program, which provides grants administered by the Maryland Higher Education Commission for facility renewal projects at local community colleges and Baltimore City Community College. The proposed reduction would leave the program with just over $1.0 million of general funds from which to make grants in fiscal 2020.

- $270,000 from the Hazardous Substance Clean-up Program administered by the Maryland Department of the Environment to fund site assessments and remediation of hazardous waste contaminated sites throughout the State. The proposed reduction would leave the program funded with just $55,000 in fiscal 2020.

The Administration has indicated that PAYGO reductions may be offset by using GO bond funds in future capital budgets. However, this raises a concern regarding the potential additional pressure placed on the capital program at a time when revenue impacts on affordability ratios might require reductions below what is planned in the *Capital Improvement Program*.

Summary

The proposed $120.7 million in reductions are the first step by the Administration to resolve the shortfall in general fund revenues resulting from the COVID-19 pandemic, which is estimated by the Board of Revenue Estimates to be between $925 million and $1.1 billion in fiscal 2020. DLS anticipates that significant agency reversions, enhanced federal funding for certain entitlement programs, and the rolling of fiscal 2020 bills into fiscal 2021 will be necessary to close out the fiscal year. The reductions proposed for the May 20 BPW meeting are one-time in nature and do not address the projected fiscal 2021 revenue gap of approximately $2.0 billion to $2.6 billion. Additional reductions at a future date will be required to address that shortfall. The proposed fiscal 2020 reductions are not without concern, but given the magnitude of the shortfall, DLS finds that the actions result in minimal negative impact to State government operations.