

DE0202B
Public School Construction
Board of Public Works

Aging Schools Program (Statewide)

General Obligation Bonds **\$6,109,000** **Recommendation:** **Reduce general obligation bonds by \$4.5 million and substitute with Qualified Zone Academy Bonds**

Bill Text: Provide additional grants to be distributed to local boards of education in proportion to grants received under § 5-206 of the Education Article.

Program Description: The Aging Schools Program provides funds to local school systems for improvements, repairs, and deferred maintenance in public school buildings. The funding formula is outlined in § 5-206 of the Education Article and is based on a specific base amount for each school system plus inflation using the Consumer Price Index (CPI).

Eligible expenditures include asbestos and lead paint abatement; upgrade of fire protection systems and equipment; painting, plumbing, and roofing; upgrade of heating, ventilation, and air conditioning systems; site redevelopment; wiring for technology; and renovation projects related to education programs and services.

Prior Authorization and Capital Improvement Program

Authorization Request
(\$ in Millions)

<i>Fund Source</i>	<i>2009 Approp.</i>	<i>2010 Approp.</i>	<i>2011 Allowance</i>	<i>2012 Estimate</i>	<i>2013 Estimate</i>	<i>2014 Estimate</i>	<i>2015 Estimate</i>
PAYGO GF	\$11.109	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000
GO Bonds	0.000	6.109	6.109	0.000	0.000	0.000	0.000
Total	\$11.109	\$6.109	\$6.109	\$0.000	\$0.000	\$0.000	\$0.000

Note: Fiscal 2012 and future years are set at zero because the program will be included in the operating budget.

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Program Analysis and Performance

Chapter 252 of 2006 added an inflation factor to the calculation of annual funding under the Aging Schools Program. Funding for each local education agency was based at the fiscal 2007 amount and was set to increase each year with changes in the CPI from the second prior fiscal year. The program received \$15.1 million in fiscal 2007, \$12.5 million in 2008, and \$11.1 million in 2009.

The Budget Reconciliation and Financing Act (BRFA) of 2009 deleted all general funds for the fiscal 2010 program, and instead \$6.1 million in general obligation (GO) bonds were used to support the program through the capital budget. The BRFA of 2009 also set general funds for the program at \$6.1 million for fiscal 2011 and \$10.4 million for 2012 and scheduled inflation adjustments to restart in 2013. The BRFA of 2010 eliminates the \$6.1 million in fiscal 2011 general funds for the program and authorizes \$6.1 million in GO bonds to be used instead. **Exhibit 1** shows the fiscal 2011 allocation by local education agency (LEA).

Exhibit 1 Fiscal 2011 Allocation

Allegany	\$97,791
Anne Arundel	506,038
Baltimore City	1,387,924
Baltimore	874,227
Calvert	38,292
Caroline	50,074
Carroll	137,261
Cecil	96,024
Charles	50,074
Dorchester	38,292
Frederick	182,622
Garrett	38,292
Harford	217,379
Howard	87,776
Kent	38,292
Montgomery	602,651
Prince George's	1,209,426
Queen Anne's	50,074
St. Mary's	50,074
Somerset	38,292
Talbot	38,292
Washington	134,904
Wicomico	106,627
Worcester	38,292
Total	\$6,108,990

Source: Section 5-206 (f) Education Article

Issues

1. Expanded Use of Qualified Zone Academy Bonds Enabled \$5.4 Million in Spending in 2009, but Unexpended Balance Remains High

Qualified Zone Academy Bonds (QZABs) were created under the federal Tax Reform Act of 1997 as a new type of debt instrument to finance education projects. Through fiscal 2009, Maryland allowed QZAB proceeds to be used only for renovation and repair (brick-and-mortar) projects as part of the Aging Schools Program. Chapter 707 of 2009 expanded the use of previously authorized QZABs for equipment, which is an authorized use under section 1397E of the Internal Revenue Service code. Chapter 707 also authorized the Maryland State Department of Education (MSDE) to allocate QZAB funds to LEAs.

At this point, Maryland has two federal QZAB allocations that have not been issued. In 2008, the State received an allocation of \$4.5 million, and this allocation will expire if it is not issued by December 31, 2010. Legislation has been introduced by the Administration (Senate Bill 202/ House Bill 171) to issue the 2008 funds. In 2009, Maryland's allocation was \$15.9 million, and bonds for these funds must be issued by December 31, 2011. The 2009 allocations were higher nationwide because the American Recovery and Reinvestment Act of 2009 (ARRA) included \$1.4 billion to expand the program.

Background

QZAB funds may be used in schools located in a federal Enterprise or Empowerment Zone or where at least 35% of the student population qualifies for free or reduced price meals (FRPM). The State does not pay interest on QZAB issuances. Instead, the State repays the principal only, and the bondholder receives a federal tax credit in lieu of interest payments each year until the bond matures. QZABs are issued with the full faith and credit of the State. Therefore, QZABs are considered State debt. For purposes of calculating State debt affordability, QZABs are included in the State's GO bond debt outstanding and debt service.

Maryland first authorized the sale of QZABs in Chapter 322 of 2000. Funds are distributed to counties based on the school systems' percentage of pre-1960 or pre-1970 (after 2004) square footage and the percentage of FRPM students enrolled in the school. Additional issuances were authorized by Chapter 139 of 2001, Chapter 55 of 2003, Chapter 431 of 2005, and Chapter 585 of 2007.

Federal law requires that QZAB projects receive a 10% private sector match, which may be in the form of cash; in-kind goods such as equipment or technology; services such as help developing curriculum; and internships or field trips. While Maryland law authorizes QZABs to be spent on brick-and-mortar projects and equipment, federal law also allows spending on curriculum development and training for teachers and other school personnel.

Unexpended QZABs Total \$21.3 Million; School Systems Have Reverted \$3.0 Million

QZAB allocations continue to exceed the rate of expenditure. As shown in **Exhibit 2**, another \$5.6 million in QZABs was issued in 2009, reflected as original proceeds. Expenditures through 2009 totaled \$29.0 million. This compares to \$23.6 million that Interagency Committee on School Construction (IAC) reported as expended by the end of 2008; therefore, \$5.4 million was spent during 2009. Unexpended funds totaled \$21.3 million at the end of 2009. IAC reports that all but \$94,200 of the funds are encumbered. **Exhibit 3** shows QZAB data by LEA.

**Exhibit 2
Expenditures of QZAB Bond Proceeds through December 31, 2009**

	<u>Original Proceeds</u>	<u>Interest Income Earned</u>	<u>Proceeds Plus Interest</u>	<u>Expenditures from Bond Proceeds</u>	<u>Unexpended Balance</u>	<u>% Expended</u>
2001/2002 QZAB	\$18,098,000	\$1,320,422	\$19,418,422	\$19,319,816	\$98,606	99.49%
2004 QZAB	9,043,000	930,000	9,973,000	5,613,184	4,359,816	56.28%
2006 QZAB	4,378,000	313,000	4,691,000	682,588	4,008,412	14.55%
2007 QZAB	4,986,000	112,000	5,098,000	1,167,538	3,930,462	22.90%
2008 QZAB	5,563,000	0	5,563,000	1,983,085	3,579,915	35.65%
2009 QZAB ¹	5,563,000	0	5,563,000	241,861	5,321,139	4.35%
Total	\$47,631,000	\$2,675,422	\$50,306,422	\$29,008,072²	\$21,298,350³	57.66%

QZAB: Qualified Zone Academy Bond

¹ Issued in December 2009.

² As of December 31, 2008, expenditures totaled \$23.6 million.

³ Of the total unexpended funds, \$21,204,171 is encumbered and \$94,179 is unencumbered.

Source: Interagency Committee on School Construction

Exhibit 3
Use of QZAB Bond Proceeds through December 31, 2009
By Local Education Agency
(\$ in Thousands)

	<u>Total</u> <u>Appropriations</u> ¹	<u>Reverted</u> <u>Appropriations</u> ²	<u>Current</u> <u>Appropriation</u> ³	<u>Expenditures</u> ⁴	<u>Unexpended</u> <u>Balance</u>
Allegany County	\$1,083	\$28	\$1,055	\$828	\$227
Anne Arundel County	2,891	205	2,686	2,184	502
Baltimore County	9,767	495	9,272	6,002	3,270
Calvert County	0	0	0	0	0
Caroline County	379	1	378	299	79
Carroll County	0	0	0	0	0
Cecil County	506	68	437	437	0
Charles County	650	1	649	618	31
Dorchester County	855	0	855	125	730
Frederick County	916	2	914	871	43
Garrett County	241	0	241	211	30
Harford County	621	0	621	621	0
Howard County	485	0	485	485	0
Kent County	1,233	3	1,230	198	1,032
Montgomery County	5,721	394	5,327	5,126	201
Prince George's County	9,675	758	8,917	3,886	5,031
Queen Anne's County	0	0	0	0	0
St. Mary's County	339	0	339	339	0
Somerset County	67	6	61	61	0
Talbot County	211	9	202	202	0
Washington County	1,368	81	1,287	616	671
Wicomico County	376	115	261	261	0
Worcester County	188	13	175	175	0
Baltimore City	15,507	800	14,707	5,349	9,357
State Bond Sale	112	0	112	112	0
Expense					
Unencumbered Funds	94	0	94	0	94
Totals	\$53,284	\$2,977	\$50,306	\$29,008	\$21,298

QZAB: Qualified Zone Academy Bond

¹ Total appropriations include new authorizations and recycled prior year authorizations as approved for each local education agency by the Board of Public Works.

² Includes a \$41,839 reversion of interest by Montgomery County.

³ As of fiscal 2010, the Maryland State Department of Education (MSDE) is authorized to award QZAB funds for equipment. Current appropriations include the following amounts approved by MSDE as of December 2009: \$1 million for Baltimore County, \$700,000 for Dorchester County, and \$1 million for Kent County.

⁴ Includes expenditures of interest earnings.

Source: Interagency Committee on School Construction

LEAs continue to use QZABs for brick-and-mortar projects, IAC reports. The main effect of the 2009 expansion has been spending on computer equipment by MSDE. As of December 2009, MSDE approved \$2.7 million to purchase technology equipment for 21 schools among three LEAs receiving support from The Breakthrough Center. This center is part of MSDE's Division of Leadership Development and helps low-performing schools gain coordinated support from MSDE and LEAs. The private sector match for the technology equipment was in the form of a discount on the purchase price.

IAC reports that school systems continue to have difficulties in securing the 10% private sector match in order to use QZAB funds. The Treasurer's Office reports that there is no strict deadline for spending the 2001 to 2007 proceeds, although the Board of Public Works expressed an expectation that each issuance would be spent within five years. A change in federal rules affected the 2008 and 2009 issuances, and will affect future issuances, in that proceeds must be spent within three years. If they are not spent, the State has to call bonds in an amount equal to the unexpended proceeds, and the funds would no longer be available. Meanwhile, LEAs have been operating under a State provision that their QZAB allocations from 2008 and 2009 issuances must be spent within two years or be reverted so they may be reallocated to another LEA. As of December 2009, \$3 million in QZABs had been reverted.

QZABs are a less expensive way to fund school renovation and equipment expenses than GO bonds. The Department of Legislative Services (DLS) recommends replacing a portion of the GO bonds with QZABs for the Aging Schools Program in fiscal 2011. IAC should comment on plans for issuing the \$15.9 million ARRA allocation of QZABs. IAC should also comment on what may be done to help LEAs use QZAB funds.

2. Aging Schools Program Funds Are Drawn Down

DLS raised an issue in the 2009 session about high levels of Aging Schools funds available that were not being spent, and at this point funds have been drawn down. As shown in **Exhibit 4**, total funds available are \$13.4 million as of December 31, 2009. This compares to \$18.3 million in funds that were available as of December 31, 2008.

Exhibit 4
Aging Schools Program Encumbrances and Expenditures
Fiscal 2009

Local Education Agency	Prior Year Encumbrances	Fiscal 2009 Expenditures	Unexpended Balance as of Dec. 31, 2009	Fiscal 2010 Working Appropriation	Total Unexpended
Allegany	\$177,829		\$177,829	\$97,791	\$275,620
Anne Arundel	920,214	\$266,463	653,751	506,038	1,159,789
Baltimore City	2,523,893	746,481	1,777,412	1,387,924	3,165,336
Baltimore	1,589,753	268,920	1,320,833	874,227	2,195,060
Calvert	69,632	69,632		38,292	38,292
Caroline	91,057		91,057	50,073	141,130
Carroll	249,604	248,466	1,138	137,261	138,399
Cecil	174,616	103,521	71,095	96,024	167,119
Charles	91,057		91,057	50,073	141,130
Dorchester				38,292	38,292
Frederick	332,091	27,640	304,451	182,622	487,073
Garrett	69,632		69,632	38,292	107,924
Harford	395,296	283,994	111,302	217,379	328,681
Howard	159,618		159,618	87,776	247,394
Kent	69,632	69,632		38,292	38,292
Montgomery	50,233	50,233		602,651	602,651
Prince George's	2,199,301	72,450	2,126,851	1,209,426	3,336,277
Queen Anne's	91,057	26,000	65,057	50,073	115,130
St. Mary's	91,057	91,057		50,073	50,073
Somerset	69,632	69,632		38,292	38,292
Talbot	69,632	69,632		38,292	38,292
Washington	245,319		245,319	134,904	380,223
Wicomico	193,898	193,898		106,627	106,627
Worcester	69,632	69,100	532	38,292	38,824
Total	\$9,993,685	\$2,726,752	\$7,266,933	\$6,108,986	\$13,375,919

Source: Interagency Committee on School Construction

The BRFA of 2009 makes it less likely that funds available will again grow dramatically, at least in the near term. The Aging Schools Program was “rebased” at \$6.1 million in fiscal 2010 and 2011, whereas the program received \$11.1 million in 2009, \$12.5 million in 2008, and \$15.1 million in 2007. Through 2009, funds were adjusted for inflation based on the CPI from the second prior fiscal year, but the BRFA of 2009 suspended this adjustment for 2010, 2011, and 2012. The program

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returns to a base funding of \$10.37 million in fiscal 2012. The inflation adjustment is set to return in 2013. **In the BRFA of 2010, DLS recommends level funding the Aging Schools Program at \$6.1 million annually.**

Recommended Actions

DE0202B Aging Schools Program \$ 1,566,000

Add the following language:

Aging Schools Program. Provide additional grants to be distributed to local boards of education in ~~proportion to grants received under~~ accordance with § 5-206 of the Education Article, provided that \$4,543,000 of this appropriation shall be reduced contingent on enactment of SB 202/HB 171 – Qualified Zone Academy Bonds.

Allowance
6,109,000

Change
-4,543,000

Authorization
1,566,000

Explanation: This action reduces funding for the Aging Schools Program by \$4.5 million contingent on the enactment of SB 202/HB 171, which authorizes the issuance of Qualified Zone Academy Bonds (QZABs). The action replaces general obligation bonds with an equal amount of QZABs to fully fund the statutory amount.