Spending Affordability Committee

2006 Interim Report

Annapolis, Maryland
December 2006

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MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 20, 2006

The Honorable Robert L. Ehrlich, Jr.
Governor, State of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Ehrlich:

We are pleased to submit the fiscal policy recommendations of the Spending Affordability Committee made during the 2006 interim. The committee adopted these recommendations at its meeting on December 19, 2006. The committee reviewed data concerning the economic condition of the State, revenue and expenditure trends during the past several years, personnel data, the Transportation Trust Fund, and the results of the Capital Debt Affordability Committee report.

The committee made recommendations concerning the fiscal 2008 spending limit, general and reserve fund balances, capital debt, transportation debt, and State positions.

The Spending Affordability Committee has completed its assigned tasks. As required by law, the recommendations of the committee have been submitted to the Governor and the Legislative Policy Committee.

We are most appreciative of the time and effort expended by each member of the committee. A special note of thanks and appreciation is extended to the members of the Citizens Advisory Committee for their valuable assistance and input.

Sincerely,

Delegate John L. Bohanan, Jr.
Presiding Chairman

Senator Edward J. Kasemeyer
Senate Chairman

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MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 20, 2006

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

Ladies and Gentlemen:

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Maryland General Assembly
Spending Affordability Committee
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Senator Edward J. Kasemeyer, Senate Chairman

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Citizens Advisory Committee

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Contents

2006 Spending Affordability Committee Report and Recommendations to the Governor and the Legislative Policy Committee

The Spending Affordability Committee was created in 1982 (Chapter 585 of 1982). The committee is composed of 20 legislative members including the presiding officers, the majority and minority leaders, the chairmen of the fiscal committees (or their designees), and other members appointed by the presiding officers. A four-member citizen advisory committee assists the committee.

The committee's primary responsibility is to recommend to the Governor and the General Assembly a level of spending for the State operating budget that is reflective of the current and prospective condition of the State's economy. Consideration is given to constraining disproportionate growth in State-funded expenditures in any fiscal year which might necessitate or "build in" unsupportable levels of spending in future years. The committee's prior recommendations and legislative action on the operating budget are reflected in the table on the following page.

The committee notes that operating spending in relation to the State's economy, as measured by the personal income statistic, is lower now than when the spending affordability process began in 1982. As illustrated in the chart on page four, throughout much of the 1980s, the ratio remained relatively stable. During the 1990 and 1991 sessions, the combination of increased spending demands and economic slowdown caused the spending ratio to increase. Following the recession, operating spending in relation to personal income fell acutely. With the onset of another recession in calendar 2001, spending in relation to personal income rose again. However, economic recovery, paired with spending restraint, caused the spending ratio to fall in 2003 to about 7 percent. The spending ratio has climbed over the last two years as the State phases in the Bridge to Excellence in Public Schools Act.

The committee's statutory responsibility is to consider spending growth in relation to growth anticipated in the State's economy. In its review of the State's economy, the committee considered both income and wealth factors in developing a broad understanding of Maryland's economic position. In determining the spending limit, the committee has considered economic performance, revenue estimates, and budget requirements.

Spending Affordability Committee's Prior Recommendations and Legislative Action on the Operating Budget
($ in Millions)

	Committee Recommendation		Legislative Action	
Session Year	**Growth Rate**	**Amount**	**Growth Rate**	**Amount**
1983	9.00%	$428.0	5.70%	$269.8
1984	6.15%	326.7	8.38%	402.0
1985	8.00%	407.2	7.93%	404.6
1986	7.70%	421.5	7.31%	402.2
1987	7.28%	430.2	7.27%	429.9
1988	8.58%	557.5	8.54%	552.9
1989	8.79%	618.9	8.78%	618.2
1990	9.00%	691.6	8.98%	689.7
1991	5.14%	421.8	5.00%	410.0
1992	No recommendation		10.00%	823.3
1993	2.50%	216.7	2.48%	215.0
1994	5.00%	443.2	5.00%	443.2
1995	4.50%	420.1	4.50%	420.0
1996	4.25%	415.0	3.82%	372.8
1997	4.15%	419.6	4.00%	404.6
1998	4.90%	514.9	4.82%	506.6
1999	5.90%	648.8	5.82%	640.6
2000*	6.90%	803.0	6.87%	800.0
2001**	6.95%	885.3	6.94%	884.6
2002	3.95%	543.2	3.40%	468.1
2003	2.50%	358.2	0.94%	134.1
2004	4.37%	635.2	4.33%	629.0
2005***	6.70%	1,037.1	6.69%	1,036.3
2006***	9.60%	1,604.7	9.57%	1,599.0

*2000 legislative action does not reflect $266 million of Cigarette Restitution Fund (CRF) appropriations. CRF dollars were excluded because they had not previously been available to the State. The 2000 growth rate including CRF dollars was 9.16 percent.

**Data from the 2001 session and subsequent years reflect a revised methodology for calculating the spending affordability limitation.

***The committee initially approved a limit of 5.70 percent for 2005 and 8.90 percent for 2006.

Economy

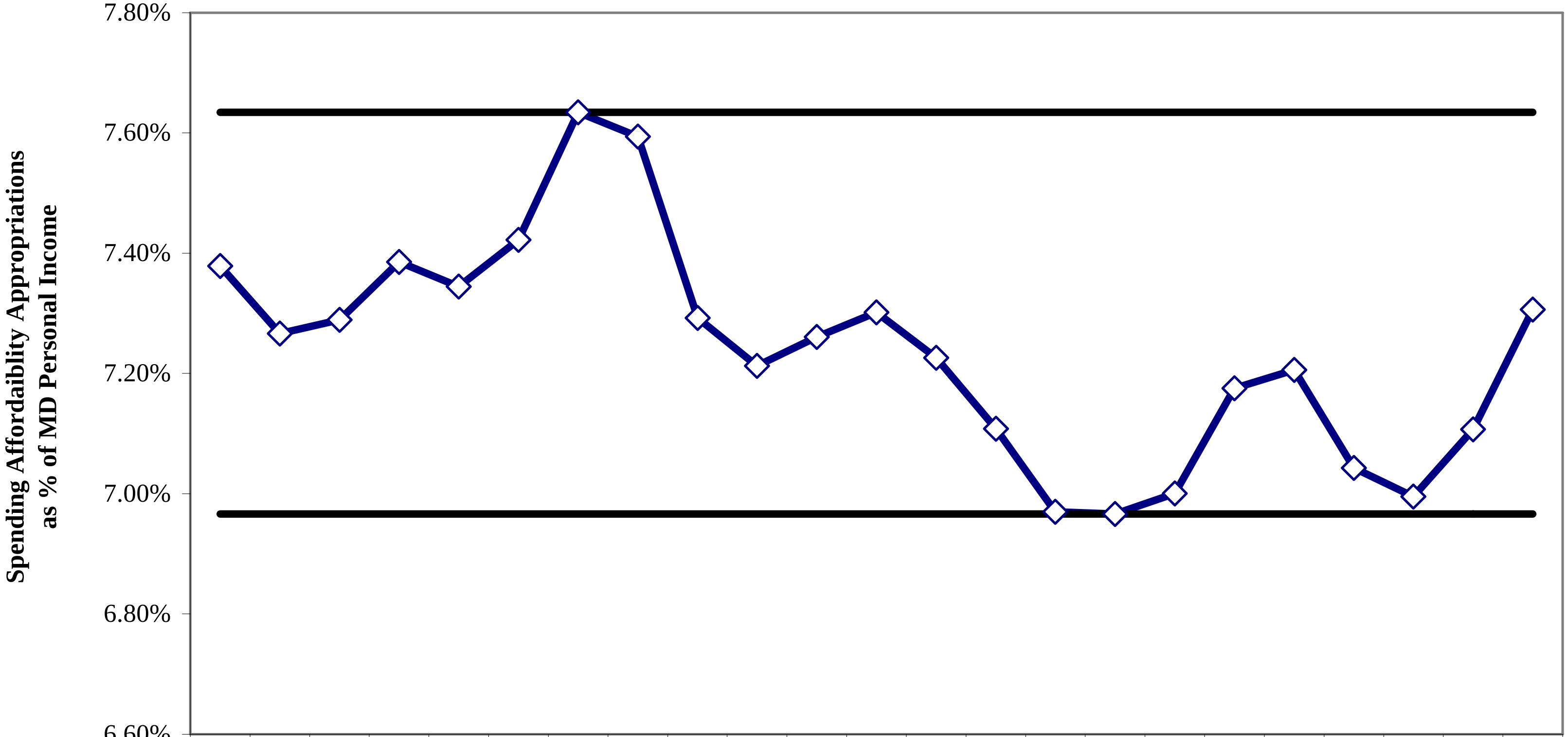
The Maryland economy marked its second year in a row of healthy growth in 2005. Employment rose by 1.5 percent, improving on the 1.2 percent pace in 2004. Wage and salary income grew 5.6 percent on par with the 5.7 percent growth in 2004. Total personal income, however, grew slower in 2005 although at 6.3 percent still at a very healthy pace. In 2004, total personal income grew 7.2 percent. In 2004, personal income was boosted by the one-time Microsoft dividend that was paid out in the fourth quarter. The data available for 2006 presents a somewhat mixed picture of the Maryland economy. Through October, employment is up 1.4 percent but growth has been slowing as the year has progressed. Employment grew 1.6 percent in the first quarter, slowing to slightly less than 1.5 percent in the second quarter and 1.3 percent in the third quarter. Personal income growth, however, has accelerated significantly from the 2005 pace. For the first half of the year, total personal income in Maryland is up 6.7 percent. Wage and salary income is up 7.9 percent compared to growth of just 5.6 percent in 2005

The economic outlook overall is not materially different from the forecast from December 2005 that was the basis of the revenue projections from the Board of Revenue Estimates. Although employment growth is expected to be slower in 2006 than previously forecasted, this is mostly due to the downward revision to 2005 employment data that was released in March 2006. Expected personal income growth in 2006 is slightly higher due to the strong year-to-date data. In 2007 the national and Maryland economies are expected to slow as higher interest rates and the significant contraction in the residential real estate market act as a drag on economic growth. Many economists expect the Federal Reserve Board to reduce interest rates in 2007. Economic growth should rebound in 2008, and the impact of the U.S. Department of Defense's Base Realignment and Closure process will begin to be felt in 2009.

Revenues

Fiscal 2006 general fund revenues exceeded the estimate by $46.5 million, or 0.4 percent. General fund revenues totaled $12.4 billion in fiscal 2006, an increase of 7.3 percent over 2005. Excluding one-time revenues, ongoing revenues grew 8.6 percent in 2006. Fiscal 2007, however, has gotten off to a much slower start. Total general fund revenues through October are up just 2.7 percent over the same period last year, 3.4 percent excluding one-time revenue in fiscal 2006. All the major revenue sources have exhibited weak growth. General fund revenues from the personal income tax are up just 3.3 percent reflecting sub-par growth in withholding and increased refunds. General fund lottery revenues are below year ago levels by 1.7 percent reflecting weak sales across the board but especially for the Mega Millions game which benefited from large jackpots this time last year. Corporate income tax revenues are down 5.5 percent reflecting weak quarterly payments in September and a sizeable increase in refunds. Sales tax revenues are up just 2.7 percent due in part to the tax free week for apparel under $100 (HB 37, 2005 session) which took place in August. Also impacting general fund sales tax

Ongoing Spending in Relation to Personal Income
Under Spending Affordability Concept



	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SA as % of PI	7.38	7.27	7.29	7.39	7.34	7.42	7.63	7.59	7.29	7.21	7.26	7.30	7.23	7.11	6.97	6.97	7.00	7.18	7.21	7.04	7.00	7.11	7.31
20-year high	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63
20-year low	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97

revenues is an increase in the credit that vendors receive for collecting the sales tax. This credit was halved for fiscal 2003-2006 but returns to its full level in fiscal 2007, taking about $18 million out of the general fund on an annual basis.

The small overattainment in fiscal 2006 combined with the weak year-to-date performance and the expectation of slowing economic growth results in a general fund forecast of less than 5.0 percent growth for both fiscal 2007 and 2008. The Department of Legislative Services (DLS) projects that general fund revenues in fiscal 2007 will be $23 million lower than the current estimate and will grow 4.0 percent over fiscal 2006. DLS projects that general fund revenues in fiscal 2008 will grow by 4.5 percent over fiscal 2007.

Budget Requirements

The committee is projecting a general fund balance of $238 million at the close of fiscal 2007. The positive balance is attributable to continued adherence to spending limits supplemented by one-time transfers and the carry-forward of fund balance from the prior year. These actions are partially offset by potential deficiency appropriations of about $59 million to address specific anticipated spending shortfalls during fiscal 2007. Areas projected to require deficiency funding include foster care, inmate medical expenses, overtime for correctional officers, and the payment of prior year bills by the Department of Juvenile Services.

Legislatively mandated increases in education aid and escalating Medicaid expenses underpin the 10.4 percent increase in the operating spending forecast for fiscal 2008. The forecast also assumes significant increases in employment-related expenses due to a general salary increase of two percent, most employees earning a salary increment, an enhancement to the retirement benefit, and an increase in the State's contribution rate for employee retirement to move the retirement system closer to full funding.

If no actions are taken to decrease expenditures or generate additional revenue, fiscal 2008 expenditures could exceed expenditures by almost $350 million. The potential shortfall is due to the anticipated growth in education and library aid of about $800 million outpacing the projected growth in ongoing revenues of $580 million and a decline in the availability of one-time transfers and temporary revenues to support spending.

The committee projects the State will close fiscal 2007 with cash reserves (from the general fund balance and Rainy Day Fund) of $1.6 billion, or 13 percent of general fund revenues. If the State draws upon the Rainy Day Fund balance to cover the entire fiscal 2008 shortfall, cash reserves would dwindle to $261 million, or 2 percent of general fund revenues by the close of fiscal 2008. Beginning with fiscal 2009, the magnitude of the structural budget gap is forecast to stabilize with annual ongoing revenues and operating expenditures each increasing at a rate of 5 percent.

Recommendations

In light of the considerations discussed above, the committee proposes the following recommendations for the 2006 session:

1. Operating Budget

A. Spending Limit and Sustainability

Appropriations subject to the spending affordability limit shall be limited to growth of no greater than 7.9 percent over those approved at the 2006 session. This limit would provide for a $1,451 million increase in appropriations at the 2007 session, allowing for total expenditures subject to spending affordability of $19,814 million.

Modest revenue growth and an imbalance between ongoing revenues and operating spending have constrained State spending in recent years. The State has provided substantial education aid increases, as mandated by the Bridge to Excellence in Public Schools Act (Thornton legislation), by limiting growth in other areas. The spending limit for the 2007 session will allow the State to complete the phase-in of the Bridge to Excellence in Public Schools Act and meet the current services needs of the remaining programs.

Together, the spending limit and the committee's recommendations (discussed below) to maintain a Rainy Day Fund balance equivalent to 5 percent of general fund revenues and reduce long-term retiree health care liabilities offer a fiscally responsible approach to meeting current spending needs and improving the State's long-term fiscal condition.

B. Calculation Adjustments

Two adjustments to the spending affordability calculation are recommended:

- excluding deficiency appropriations submitted at the 2007 session in lieu of budget amendments from the spending affordability calculation; and

- adjusting the base to capture general fund spending for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds.

The General Assembly added language to the fiscal 2007 budget bill directing the Department of Budget and Management to establish policies and procedures to minimize reliance on budget amendments for appropriations that could be included in the budget bill as a deficiency appropriation. Since the spending affordability limit is calculated by comparing appropriations approved during the legislative session to the appropriations approved at the prior session, the spending limit is not applicable to funds added through the statutory budget amendment process but does apply to deficiency appropriations. **To encourage compliance**

with the new policy, the committee authorizes DLS to exclude from the calculation of the 2007 session spending limit any deficiency appropriations that could otherwise be submitted as budget amendments.

In the 2005 Spending Affordability Committee report, the committee recommended that the State appropriate general funds for capital programs and projects that are not eligible to receive bond proceeds from tax exempt bonds. To remove the potential disincentive to replace taxable debt with general fund appropriations, the committee also recommended excluding PAYGO capital appropriations for projects previously funded with taxable general obligation bonds from the affordability calculation. **With the conversion from taxable bonds to general fund PAYGO now complete, the committee recommends including general fund PAYGO for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds in the affordability limit. This change in policy will ensure that fiscal constraints are applied to these ongoing portions of the PAYGO program.**

2. Rainy Day Fund

In addition to its general fund recommendations, the committee also recommends a prudent use of the Revenue Stabilization Account ("Rainy Day Fund") to address general fund needs. The committee projects a Rainy Day Fund balance at the beginning of fiscal 2008 equivalent to about 12 percent of estimated general fund revenues or $930 million more than the statutory requirement for a balance of at least 5 percent of the estimated general fund revenues.

Because the Rainy Day Fund balance is projected to exceed 5 percent of the estimated general fund revenue and the State faces a potential gap between ongoing revenues and operating spending of $1.3 billion, the committee supports the withdrawal of funds so long as the closing funds balance exceeds 5 percent of estimated general fund revenues. Any reduction in the balance below 5 percent must be accompanied by a long-term solution to the imbalance between ongoing revenues and operating spending.

3. Capital Budget

A. General Obligation (GO) Debt

The committee concurs with the recommendation of the Capital Debt Affordability Committee (CDAC) that a maximum of $810 million in general obligation bonds may be authorized at the 2007 session. This level allows for a $120 million increase in spending over the 2006 session authorization and includes $3 million to the Tobacco Transition Program.

The recommendation to increase the authorization by $120 million in the 2007 session reflects a change in the CDAC's authorization policy. In response to high demand for capital spending, the committee increased authorizations by $100 million more than previously planned.

The remaining $20 million increase was planned in 2006. This increase is affordable within the CDAC's framework, which requires that State debt outstanding not exceed 3.2 percent of State personal income and that State debt service not exceed 8 percent of State revenues supporting debt service.

The committee concurs in the recommendation of the Capital Debt Affordability Committee that up to $810 million in new general obligation bonds may be authorized at the 2007 session.

The $100 million increase proposed by CDAC marks the sixth policy change to increase authorizations since the 2000 legislative session. Over the period, the State has also authorized two new forms of debt: bay restoration bonds and Grant Anticipation Revenue Vehicles. The increased authorizations have reduced the State's unused debt capacity. In fiscal 2000, State debt outstanding was 77 percent of capacity. It is projected to be 93 percent of capacity in fiscal 2009. Furthermore, small changes in personal income, such as slower than expected growth, can push debt over the limit as the State gets closer to the threshold.

The Spending Affordability Committee supports the prudent debt policies adopted by CDAC in 1979. These policies have helped the State maintain its AAA bond rating. The recent growth in debt authorizations has been within these guidelines. However, the increases have pushed the State closer to the debt limits. Current estimates suggest that continually expanding authorizations cannot continue indefinitely. The committee is concerned that the continually increasing authorizations will push the State over CDAC's limits. The committee recommends that CDAC carefully consider the implication of further adjustments to debt policy.

B. Higher Education Debt

For fiscal 2008 the University System of Maryland intends to issue up to $60 million in auxiliary debt and $30 million in academic debt. This level of issuance will result in a debt service ratio within the 5.5 percent of current unrestricted funds and mandatory transfers criterion recommended by the system's financial advisers. Morgan State University, St. Mary's College, and Baltimore City Community College do not plan on issuing any debt in fiscal 2008. **The committee concurs in the recommendation of CDAC that $30 million in new academic revenue bonds may be authorized for the University System of Maryland in the 2007 session.**

C. Transportation Debt

The Maryland Department of Transportation (MDOT) competes with other State capital projects within debt affordability limits. Transportation debt capacity is limited by the constraints on debt outstanding, debt service coverage, the cash flow needs for projects in the capital program, and overall State debt affordability limits.

The committee recommends that the General Assembly continue to set an annual limit on the level of State transportation debt so as to maintain debt outstanding within the 3.2 percent of personal income debt affordability criterion and debt service within the 8.0 percent of revenues debt affordability criterion.

4. Operating Maintenance Exclusion

For the last six years, operating spending by the Department of General Services (DGS) on facilities maintenance projects above a base funding level of $2 million has been excluded from the spending affordability calculation. The exclusion was initially authorized in the committee's December 2000 report, which noted a backlog of operating maintenance projects at State facilities in the magnitude of $47 million. Left unaddressed, the committee recognized that this could lead to further deterioration of the State's infrastructure and to higher costs in the long run.

Despite the exclusion, DGS reports that it currently has a $37.1 million backlog of deferred maintenance and repair work, $22.1 million of which is rated as a medium priority (posing a high economic risk). In a September 2005 report to the budget committees, DGS estimated that the backlog could eventually be eliminated by fiscal 2019 by increasing the annual deferred maintenance appropriation to $5 million. These projections assume that new projects accumulate at the historical annual average of $2.4 million a year. With a total fiscal 2007 appropriation of $8 million in the DGS budget to fund deferred maintenance, significant progress towards this objective was initiated. **In an effort to reduce the backlog, the committee continues to support the exclusion from the spending affordability calculation of operating maintenance spending by DGS above the historical spending level of $2 million.**

5. State Employment

A. Limits on Workforce Growth

Personnel costs comprise approximately one fourth of the State operating budget; the use of position ceilings in fiscal 2003 through 2007 helped mitigate the State's long-term structural budget gap by slowing the growth in personnel spending in those years. Position ceilings imposed by the General Assembly for fiscal 2003 through 2007 have resulted in a decline in the size of the State's regular workforce from 82,087 full-time equivalent positions in fiscal 2002 to 80,254 in fiscal 2007.

Despite the decline in the number of authorized positions, the committee notes that, exclusive of higher education, there are currently almost 4,200 vacant Executive Branch positions, approximately 1,368 of which are funded, in the fiscal 2007 budget. The high number of funded vacant positions suggests that many additional workforce needs can be addressed through full utilization and reallocation of existing resources.

The committee anticipates additional workforce needs in fiscal 2008 to staff a new maximum security wing at the Clifton T. Perkins Hospital Center, meet Child Welfare League of America recommended caseload to staff ratios, and phase in the assumption of full responsibility by the Maryland State Department of Education for residential education programs formerly in the Department of Juvenile Services.

The committee notes the success of the position cap in reducing the size of the State workforce but recognizes that long-term restrictions on position growth may impede the ability of some agencies to carry out their missions. Therefore, the committee recommends that growth in the number of Executive Branch positions, exclusive of higher education, be limited to 1 percent (533 positions) over the number of full-time equivalent authorized positions in the fiscal 2007 working appropriation.

New positions should be created, however, only when it can be demonstrated that existing vacant positions are filled to the extent feasible. To encourage agencies to fill vacancies, the committee recommends that no new positions be authorized in principal units in the Executive Branch, exclusive of higher education, with vacancy rates in excess of 8 percent.

The committee recommends that exceptions to both the 1 percent growth rate limit and the 8 percent vacancy ceiling be made for facilities scheduled to open in fiscal 2008 and position additions necessary to implement legislation.

B. Workforce Planning

The easing of restrictions on adding new positions should not be construed as encouragement to do so, but recognition that agencies should possess the ability to manage their workforces, consistent with their mission, legislative intent, and the limits imposed by the budget. **To help determine whether agencies are fully utilizing existing resources, the committee requests that the Department of Budget and Management produce a report in which a determination of the appropriateness of vacancy levels in each agency is made. The standards used should include historic vacancy rates and turnover rates, the actual time necessary to fill vacant positions, and the relationship between the vacancy rate and the budgeted turnover expectancy rate.**

Part 1

Economic Outlook

Recent Economic Performance

Year-over-year Percent Change

Calendar Year	U.S. Economy GDP	U.S. Economy Employment	U.S. Economy Personal Income	U.S. Economy Existing Home Sales	Maryland Economy Employment	Maryland Economy Personal Income	Maryland Economy Existing Home Sales
2001	0.8%	0.0%	3.5%	8.1%	0.7%	5.3%	12.9%
2002	1.6%	-1.1%	1.8%	8.2%	0.3%	3.7%	3.7%
2003	2.5%	-0.3%	3.2%	1.6%	0.3%	3.8%	8.6%
2004	3.9%	1.1%	6.2%	16.1%	1.2%	7.2%	10.6%
2005	3.2%	1.5%	5.2%	-2.9%	1.5%	6.3%	0.3%
	Year-to-date				*Year-to-date*		
2006	3.6%	1.4%	7.3%	-6.9%	1.4%	6.7%	-20.7%

GDP: inflation-adjusted gross domestic product

Note: Data for 2006 are through June for GDP and Maryland personal income, through August for U.S. personal income, and U.S. home sales, and through September for U.S. employment, Maryland employment, and Maryland home sales.

Sources: GDP and personal income data from the Bureau of Economic Analysis, U.S. Department of Commerce; Employment data from the Bureau of Labor Statistics, U.S. Department of Labor; U.S. home sales from the National Association of Realtors; Maryland home sales from the Maryland Association of Realtors

Maryland Economic Forecasts
December 2005 Compared to October 2006

Year-over-year Percent Change

Calendar Year	Employment Dec. 2005	Employment Oct. 2006	Personal Income Dec. 2005	Personal Income Oct. 2006
2003	0.4%	0.3%	3.8%	3.8%
2004	1.1%	1.2%	6.8%	7.2%
2005	2.0% *	1.5%	6.3% *	6.3%
2006E	2.0%	1.6%	6.4%	6.6%
2007E	1.6%	1.2%	5.5%	5.6%
2008E	1.8%	1.6%	5.3%	6.0%
2009E	1.8%	1.8%	5.3%	6.1%

* Estimates

Part 2

General Fund Revenues

Fiscal 2006 General Fund Revenues

($ in Millions)

Source	Actual FY 2005	Fiscal 2006 Estimate*	Fiscal 2006 Actual	Fiscal 2006 Difference	Percent Change FY 2005-2006
Personal Income Tax	$5,660.6	$6,206.8	$6,200.2	-$6.6	9.5%
Sales and Use Tax	3,129.4	3,350.6	3,355.2	4.6	7.2%
State Lottery	455.9	471.3	480.5	9.1	5.4%
Corporate Income Tax	512.2	604.7	623.2	18.5	21.7%
Business Franchise Taxes	197.9	200.7	196.2	-4.5	-0.8%
Insurance Premiums Tax	268.9	265.7	274.9	9.2	2.2%
Estate and Inheritance Taxes	183.1	245.9	221.9	-24.0	21.2%
Tobacco Tax	276.0	278.2	280.3	2.1	1.5%
Alcohol Beverages Tax	27.3	27.7	28.0	0.2	2.2%
Motor Vehicle Fuel Tax	13.2	13.3	13.2	-0.1	0.4%
District Courts	87.4	93.0	91.3	-1.7	4.4%
Clerks of the Court	55.5	51.8	58.7	6.9	5.8%
Hospital Patient Recoveries	85.1	83.5	85.8	2.3	0.7%
Interest on Investments	64.4	134.0	162.5	28.5	152.3%
Miscellaneous	377.7	296.1	298.1	2.0	-21.1%
Total Current Revenues	**$11,394.7**	**$12,323.4**	**$12,369.9**	**$46.5**	**8.6%**
Delaware Holding Co. Settlements [1]	151.0	20.4	20.4	0.0	n/a
Miscellaneous Transfers	2.3	0.0	0.0	0.0	-100.0%
Grand Total	**$11,548.0**	**$12,343.8**	**$12,390.3**	**$46.5**	**7.3%**

* From the Board of Revenue Estimates, March 2006 with adjustments for action at the 2006 legislative session.

[1] In fiscal 2005, the settlement relating to the use of Delaware holding companies authorized by SB 187 (2004 session) resulted in payments of $207.8 million and refunds from the Comptroller's settlement program of $9.0 million for a net of $198.7 million. The general fund received $151.0 million and the Transportation Trust Fund received $47.7 million. In fiscal 2006, the Comptroller's settlement with MCI resulted in $26.8 million in corporate income tax, $20.4 million going to the general fund. Because the revenue is of a one-time nature, it is not included with the corporate income tax.

Fiscal 2007 General Fund Revenues

($ in Millions)

Source	FY 2006	FY 2007	$ Difference	% Difference
	Fiscal Year through October			
Personal Income Tax	$1,588.5	$1,640.9	$52.4	3.3%
Sales and Use Tax	817.6	839.6	22.0	2.7%
State Lottery	143.1	140.7	-2.4	-1.7%
Corporate Income Tax	157.6	148.9	-8.7	-5.5%
Business Franchise Taxes	41.9	39.8	-2.1	-4.9%
Insurance Premiums Tax	66.1	74.3	8.3	12.5%
Estate and Inheritance Taxes	75.4	96.7	21.3	28.3%
Tobacco Tax	80.1	81.3	1.2	1.5%
Alcohol Beverages Tax	6.8	6.9	0.1	1.4%
Motor Vehicle Fuel Tax	2.4	2.4	0.0	0.8%
District Courts	29.7	35.1	5.4	18.3%
Clerks of the Court	23.7	20.8	-2.8	-12.0%
Hospital Patient Recoveries (1)	2.9	3.5	0.7	23.1%
Interest on Investments	18.8	22.8	3.9	20.8%
Miscellaneous	45.5	51.4	5.9	13.0%
Total Current Revenues	**$3,099.9**	**$3,205.2**	**$105.3**	**3.4%**
MCI Settlement	20.4	0	-20.4	n/a
Grand Total	**$3,120.3**	**$3,205.2**	**$84.9**	**2.7%**

(1) Includes revenues from Medicare, insurance, and sponsors only.

General Fund Revenue Projections

($ in Millions)

Source	FY 2006 Actual	---- FY 2007 Estimate ---- May*	October	$ Diff.	% Change FY06-07	FY 2008 Estimate	% Change FY07-08
Personal Income Tax	$6,200.2	$6,578.9	$6,551.3	-$27.6	5.7%	$6,944.2	6.0%
Sales and Use Tax [1]	3,355.2	3,501.5	3,487.7	-13.8	4.0%	3,653.8	4.8%
State Lottery [2]	480.5	483.4	479.8	-3.5	-0.1%	502.6	4.8%
Corporate Income Tax	623.2	685.7	619.5	-66.2	-0.6%	643.6	3.9%
Business Franchise Taxes	196.2	202.6	193.2	-9.4	-1.6%	199.6	3.3%
Insurance Premiums Tax	274.9	273.7	285.7	11.9	3.9%	297.8	4.2%
Estate and Inheritance Taxes	221.9	219.4	237.5	18.1	7.0%	214.7	-9.6%
Tobacco Tax	280.3	279.2	281.7	2.6	0.5%	282.9	0.4%
Alcohol Beverages Tax	28.0	28.2	28.7	0.4	2.5%	29.3	2.1%
Motor Vehicle Fuel Tax	13.2	13.7	13.7	0.0	3.8%	13.8	1.0%
District Courts [3]	91.3	101.6	100.3	-1.2	9.9%	101.9	1.6%
Clerks of the Court	58.7	46.9	54.7	7.8	-6.8%	54.8	0.2%
Hospital Patient Recoveries	85.8	83.9	83.9	0.0	-2.1%	85.0	1.2%
Interest on Investments	162.5	117.4	167.1	49.7	2.8%	138.9	-16.9%
Miscellaneous	298.1	298.6	306.8	8.2	2.9%	307.9	0.4%
Total Current Revenues	**$12,369.9**	**$12,914.7**	**$12,891.6**	**-$23.1**	**4.2%**	**$13,471.0**	**4.5%**
MCI Settlement	20.4	0.0	0.0	0.0	n/a	0.0	n/a
Grand Total	**$12,390.3**	**$12,914.7**	**$12,891.6**	**-$23.1**	**4.0%**	**$13,471.0**	**4.5%**

* From the Board of Revenue Estimates, March 2006, with adjustments for legislative action at the 2006 session.

[1] The vendor credit was halved for fiscal 2003 to 2006, increasing general fund revenues by $14 million to $18 million per year. In fiscal 2007, the vendor credit returns to its previous level, resulting in less general fund revenue relative to fiscal 2006. Fiscal 2007 also reflects the impact of HB 37 (2005 session) which provided for a tax-free period on certain back-to-school items in August 2006.

[2] HB 147 (2005 session) increased the agent commissions from 5.0 to 5.5% starting in fiscal 2007.

[3] HB 147 (2005 session) increased traffic and criminal court fees from $20.00 to $22.50. In fiscal 2006, that additional revenue goes to the Law Enforcement and Correctional Training Fund. In fiscal 2007, that fund is eliminated and the revenues go to the general fund.

Part 3

General Fund Budget

2008 Baseline Budget Forecast Assumptions

Baseline Budget Concepts

- Current laws, policies, and practices are continued.
- Inflationary increases are recognized.
- Large one-time purchases and nonrecurring PAYGO expenditures are removed.
- Anticipated deficiencies are identified.
- Federal mandates and multi-year commitments are observed.
- Legislation adopted at the prior session is funded.
- Nondiscretionary changes in workload are recognized.
- Full year costs of programs started during the previous year are included.
- Positions and operating expenses associated with new facilities are recognized.
- Employee turnover is adjusted to reflect recent experience.

Caseload Assumptions

	FY 2006	FY 2007	FY 2008	Percent Change FY 07-08
Pupil Enrollment *	829,007	827,596	828,108	0.1%
Medicaid	525,076	531,300	537,819	1.2%
Children's Health	103,260	112,070	116,350	3.8%
Temporary Cash Asst.	57,589	51,830	49,239	-5.0%
Foster Care/Adoption	13,910	14,065	14,265	1.4%

* Data for 2006, 2007, and 2008 reflect 9/04, 9/05, and 9/06(est.) full-time equivalent enrollments.

2008 Baseline Budget Forecast Assumptions (Cont.)

Inflation Assumptions

- Employee health insurance (8% inflation).
- Medical contracts and supplies (5%).
- Prescription drugs for State facilities (8%).
- Motor vehicle fuel (20% over fiscal 2006 costs).
- Food (annual growth of 3% since fiscal 2006).
- Postage (3 cents on standard mail/7.1%) and supplies (3%).

Employee Compensation

- Merit increases (increments) of 2 or 4% based on salary schedule.
- 2% general salary increase for fiscal 2008.

Other Assumptions

- Cost increases for the University System of Maryland and Morgan State University are allocated between general funds and tuition and fees based on the current ratio of general funds to tuition and fees.
- Due to litigation that may adversely impact Cigarette Restitution Fund (CRF) revenues, the baseline assumes revenues will fall $17.7 million below estimates in both fiscal 2007 and 2008. The baseline also assumes that $26 million of the fiscal 2007 appropriation for Medicaid will not be available for expenditure as the funds are restricted pending favorable resolution of the litigation. All statutory mandates are funded in the fiscal 2008 baseline.

Fiscal 2007 Deficiencies
($ in Millions)

	Dollars
Public Safety: Underfunding of inmate medical contract ($10 million), overtime ($8.7 million), purchase of safety equipment for public safety officers ($7.2 million), and utilities/ fuel ($5 million)	$30.9
Juvenile Services: Underfunding of per diem placements ($0.3 million), recently approved security and placement contracts exceed budgeted amounts ($1.2 million), fiscal 2006 costs rolled into fiscal 2007 ($9.0 million), and re-opening of Victor Cullen facility ($1.9 million)	12.4
Foster Care: Correcting prior year accounting errors. Deficiency is net of surplus in fiscal 2007 budget. The surplus funds $13.7 million of accounting errors as well as a projected shortfall in the Family Investment Program ($10 million)	8.0
Medicaid: Cost associated with implementing federally mandated verification of citizenship	4.0
MSDE: Higher than anticipated utilization of services by participants in autism waiver ($0.5 million) and rising nonpublic placement costs ($1.5 million)	2.0
Other	1.2
Total	**$58.5**

Fiscal 2007 Medicaid Outlook
General Funds
($ in Millions)

Fiscal 2007 General Fund Appropriation	$2,162
Cost Savings	
Excess Fiscal 2006 Dollars	-20
Fiscal 2007 Budget Developed Off Overstated Fiscal 2006 Appropriation	-20
Favorable Inflation and Utilization Trends	-31
Total	**-$71**
Additional Costs	
Backfill for Cigarette Restitution Funds That Are Contingent Upon Favorable Resolution of Legal Challenge	26
Maryland Children's Health Program – Federal Block Grant Exhausted	19
Increase Managed Care Rates 5.3%	23
Restore Coverage for Certain Legal Immigrants	3
Total	**$71**

State Expenditures – General Funds
($ in Millions)

Category	Work Appr. FY 2006	Leg. Appr. FY 2007	Baseline FY 2008	$ Diff. 07 to 08	% Diff. 07 to 08
Debt Service	$0.0	$0.0	$80.5	$80.5	n/a
Aid to Local Governments					
General Government	228.9	230.3	237.2	6.9	3.0%
Community Colleges	191.6	205.9	245.4	39.5	19.2%
Education/Libraries	4,065.8	4,534.9	5,344.7	809.8	17.9%
Health	61.9	63.1	65.1	2.0	3.2%
	$4,548.2	**$5,034.2**	**$5,892.4**	**$858.2**	**17.0%**
Entitlements					
Foster Care Payments	216.4	250.8	229.0	-21.7	-8.7%
Assistance Payments	48.6	43.6	42.6	-0.9	-2.1%
Medical Assistance	2,057.2	2,169.9	2,354.1	184.2	8.5%
Property Tax Credits	52.0	72.0	72.1	0.1	0.2%
	$2,374.3	**$2,536.3**	**$2,697.9**	**$161.7**	**6.4%**
State Agencies					
Health	1,254.0	1,325.5	1,393.6	68.2	5.1%
Human Resources	286.3	310.5	327.5	17.0	5.5%
Systems Reform Initiative	34.2	32.2	37.9	5.7	17.7%
Juvenile Services	194.7	214.4	224.9	10.4	4.9%
Public Safety/Police	1,046.5	1,129.9	1,272.0	142.1	12.6%
Higher Education	909.5	1,026.7	1,117.2	90.6	8.8%
Other Education	333.2	359.1	395.5	36.5	10.2%
Agric./Natl. Res./Environment	122.7	138.9	157.6	18.7	13.5%
Other Executive Agencies	553.3	694.2	620.1	-74.1	-10.7%
Judicial/Legislative	358.8	394.5	406.5	12.0	3.0%
Across-the-board Cuts	0.0	-37.6	0.0	37.6	-100.0%
	$5,093.2	**$5,588.3**	**$5,952.9**	**$364.6**	**6.5%**
Deficiencies	0.0	58.5	0.0	-58.5	-100.0%
Transfer from Dedicated Purpose Account*			-37.6	-37.6	n/a
Subtotal	**$12,015.7**	**$13,217.2**	**$14,586.1**	**$1,368.9**	**10.4%**
Capital	5.5	135.8	86.3	-49.5	-36.4%
Multi-Year Commitments**	70.0	183.0	183.0	0.0	0.0%
Reserve Fund	281.7	656.0	162.8	-493.2	-75.2%
Appropriations	**$12,372.9**	**$14,191.9**	**$15,018.2**	**$826.2**	**5.8%**
Reversions	-27.2	-20.0	-20.0	0.0	0.0%
Grand Total	**$12,345.7**	**$14,171.9**	**$14,998.2**	**$826.2**	**5.8%**

*The General Assembly earmarked excess health insurance funds in the fiscal 2007 budget for transfer to the Dedicated Purpose Account to pay for future retirement expenses.

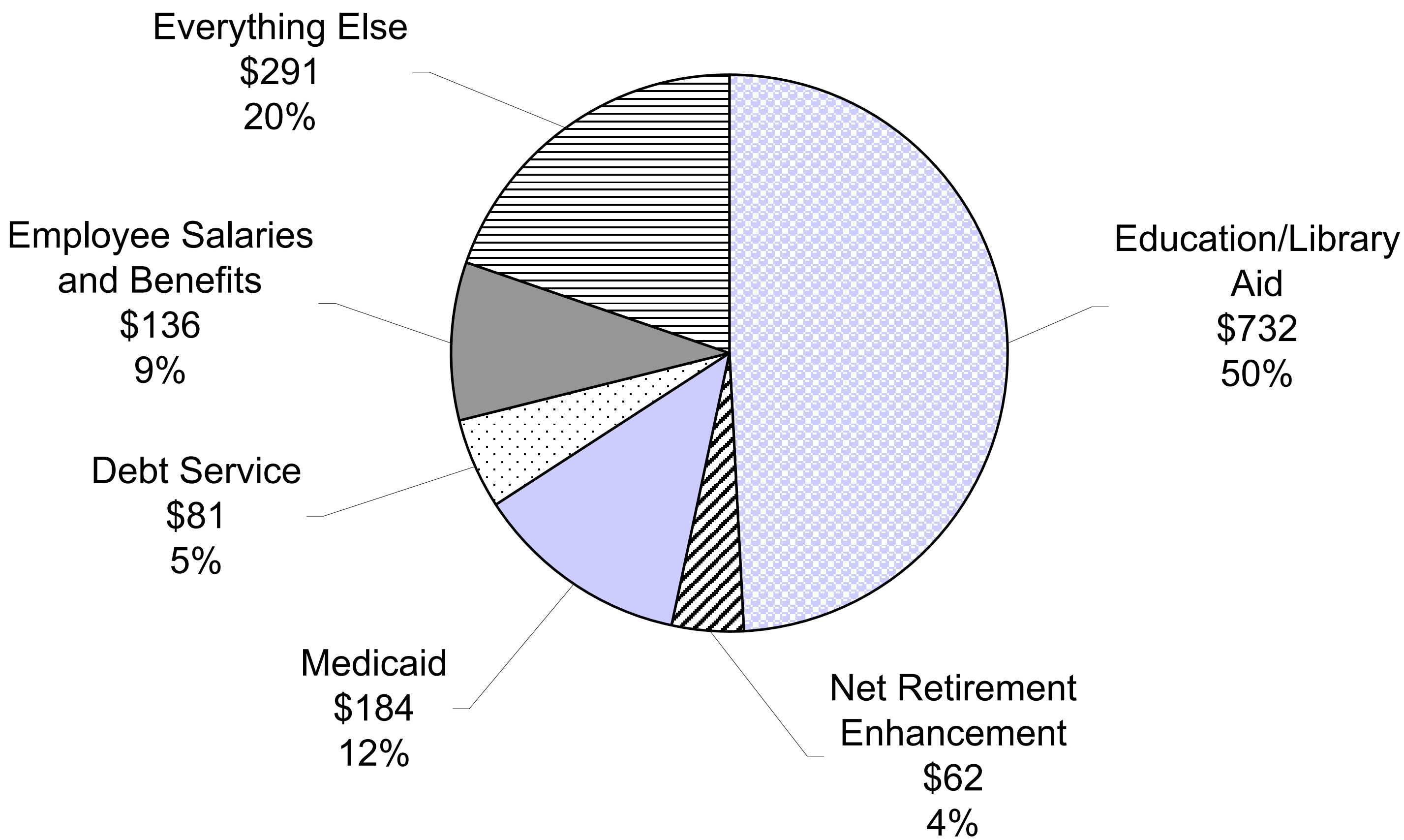
** Heritage Reserve Fund, Repayment of Transportation Trust Fund, and Retiree Health Liability.

Fiscal 2008 General Fund Spending Growth

Excludes PAYGO and Reserve Fund

Total Growth = $1.5 Billion

($ in Millions)



Components of Budget Change
($ in Millions)

Summary of Budget Change	Dollars	Share of Growth
Ongoing Requirements/Entitlements	$967.5	65%
Legislation	158.8	11%
Commitments	111.4	7%
State Agency Costs	248.2	17%
Subtotal Operating Budget	**$1,485.9**	**100%**
PAYGO	-49.5	
Appropriation to Reserve Fund	-493.2	
Total Baseline Increase in State Expenditures	**$943.2**	
Less Deficiency Appropriations	-58.5	
Total	**$884.7**	

Detail on Components
($ in Millions)

Ongoing Requirements/Entitlements		**$967.5**
Education/Library Aid	$636.0	
Medical Assistance – Enrollment, Inflation, MCO Rates	184.2	
Debt Service	80.5	
Community Colleges	35.0	
Mental Hygiene − Enrollment, Inflation, and Utilization	15.2	
Higher Education (St. Mary's College, BCCC, Sellinger Formula)	14.4	
Disparity Grant for Low Wealth Counties	5.1	
Formula Aid for School for the Deaf and School for the Blind	3.9	
Formula Aid to Local Governments for Police Protection and Health	3.4	
Mandated Salary Enhancements for Judges	1.5	
Autism Waiver – Costs Rise Due to Medical Inflation	1.4	
Baltimore City and Ocean City Convention Center Deficits	0.8	
Mandated Increase for Maryland State Arts Council	0.7	
General Fund Spending on Foster Care Declines Due to Availability of Federal Funds	-13.7	
Cash Assistance Costs Fall Due to Caseload Reductions	-0.9	

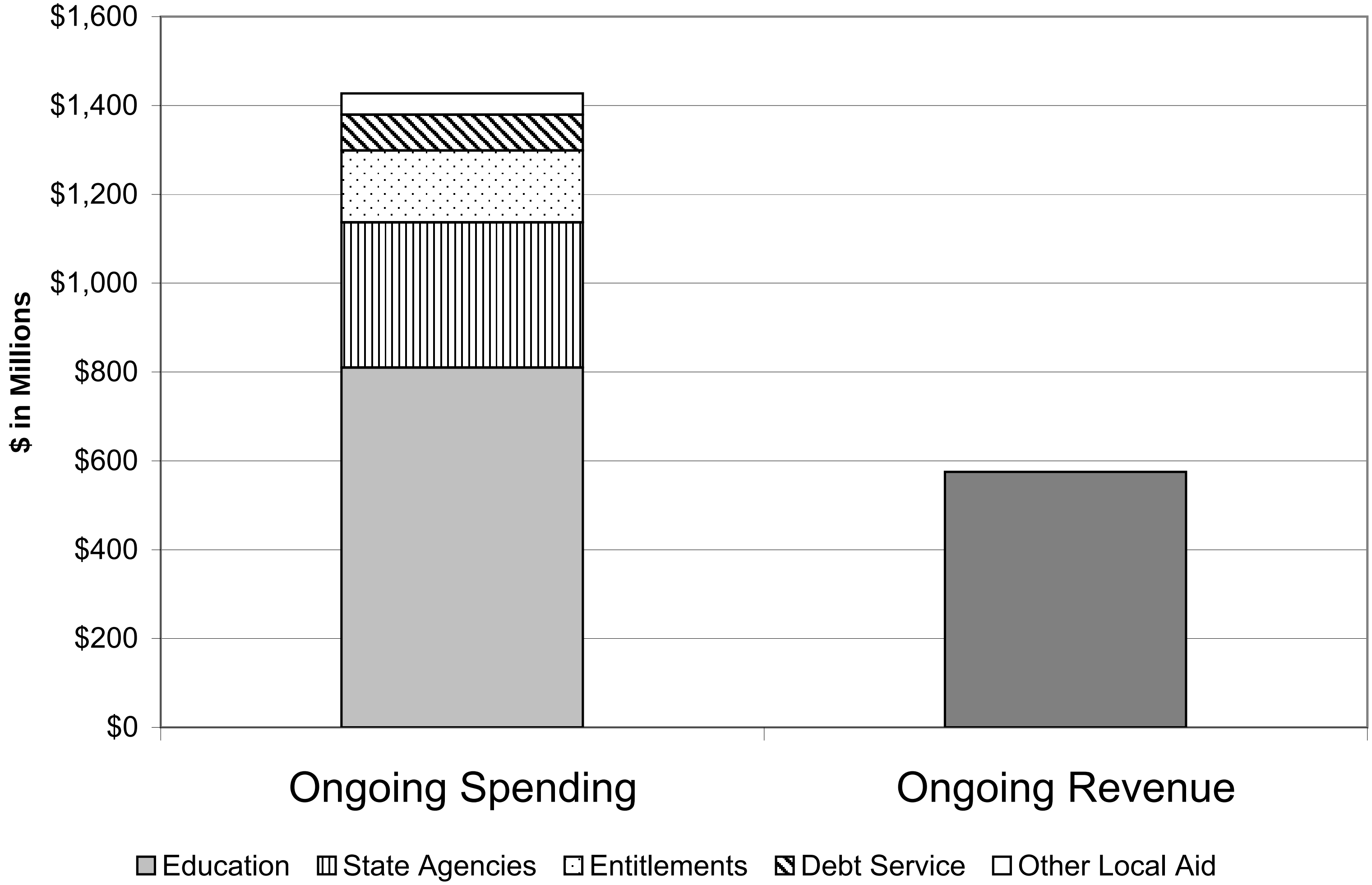
Detail on Components (Continued)
($ in Millions)

Legislation Adopted at 2006 Session		**$158.8**
Retirement Enhancement for Teachers ($78.1 Million) and State Employees ($21.7 Million) – Chapter 110, Acts of 2006	$99.8	
COLA for Community Providers Funded by Mental Hygiene and Developmental Disabilities Administrations – Chapter 256, Acts of 2006	17.8	
Agricultural Stewardship Act – Chapter 289, Acts of 2006	9.7	
Enhance At-Risk Youth Prevention and Diversion Programs – Chapter 445, Acts of 2006	5.7	
Enhance Community College Funding – Chapter 333, Acts of 2006	4.2	
Veterans of the Afghanistan and Iraq Conflicts Scholarships – Chapter 290, Acts of 2006	3.1	
Loans to Veterans/Reserves Called to Active Duty – Chapter 389, Acts of 2006	3.0	
Community College Access Initiative – Chapter 496, Acts of 2006	2.2	
Adult Education – Literacy Works Grants – Chapter 380, Acts of 2006	1.5	
Educational Technology Pilot Program – Chapter 276, Acts of 2006	1.2	
Increase Community College Grants for English for Speakers of Other Languages – Chapter 262, Acts of 2006	1.2	
Other Legislation with Impact Less Than $1 Million	9.4	
Commitments		**$111.4**
Geographic Cost of Education Index	$95.7	
Annualize Fiscal 2006 Cost of New Community Placements of Developmentally Disabled	8.0	
191 Caseworker, Supervisor, and Support Positions to Attain Child Welfare League of America's Caseload to Staff Ratios	5.7	
Medicaid Operating Costs Associated with Changes to Federal Law	4.5	
Voting Machine Operations and Maintenance Contract	4.2	
Infants and Toddlers Program Formula – Chapter 312, Acts of 2002	3.0	
Restore Funding for Family Support Centers ($1.7 million) and Child Care Resource and Referral Networks to Fiscal 2003 Levels	2.9	
Public School Facilities Assessment Survey	2.8	
Lease Payments for Wiring Schools for Technology Project	2.6	
44-bed Wing at Perkins Hospital to Open in Final Quarter of Fiscal Year	2.2	
Annualize Substance Abuse Treatment Funding Enhancement	1.0	
Ongoing Shift of Responsibility for Education at Juvenile Facilities from the Department of Juvenile Services to MSDE	1.0	
African American Museum – State to Cover 50% Not 75% of Operating Budget	-0.9	
Remove One-time Cost for Medicare Part D and Helicopter Repayment	-3.6	
Major Information Technology Projects Per DBM Schedule	-17.8	

Detail on Components (Continued)
($ in Millions)

State Agency Costs		**$248.2**
University System of Maryland (USM) and Morgan State University	$52.0	
Employee Increments	48.5	
2% General Salary Increase (Includes Higher Education)	48.2	
Public Safety's Inmate Medical Contract Including $10 Million Deficiency	30.0	
Utility and Vehicle Fuel Inflation	28.5	
State Contribution for Employee Retirement (Excluding Enhancement)	21.1	
Security Equipment and Overtime at Correctional Facilities	21.1	
Juvenile Services − Fiscal 2007 Underfunding, Rising Placements Costs, and Annualization of New Contracts	16.5	
Salary Enhancements for Selected Classes of Employees Per Annual Salary Review Process	10.0	
Employee and Retiree Health Insurance	6.8	
Scholarships Rise by 5% to Keep Pace with Tuition at USM	2.8	
Public Defender – Hourly Rate for Panel Attorneys Increases	2.0	
Workers' Compensation Charges	1.7	
Public Defender Rent – Moving from Baltimore City Juvenile Justice Center	1.1	
Aging Schools – Remove One-time Grants	-5.4	
Use Dedicated Purpose Fund to Offset Retirement Costs	-37.6	
Other Changes	1.0	
PAYGO (Including $39 Million Associated with Legislation)		**-$49.5**
State Reserve Fund		**-$493.2**
Unappropriated Fund Balance from Fiscal 2006	$162.8	
Remove Appropriation to Rainy Day Fund of Fiscal 2005 Fund Balance in Excess of $10 Million	-593.3	
Remove Fiscal 2007 Dollars Earmarked for Future Retirement Costs	-37.6	
Remove One-time Appropriation to Dedicated Purpose Account for Energy Assistance	-25.1	

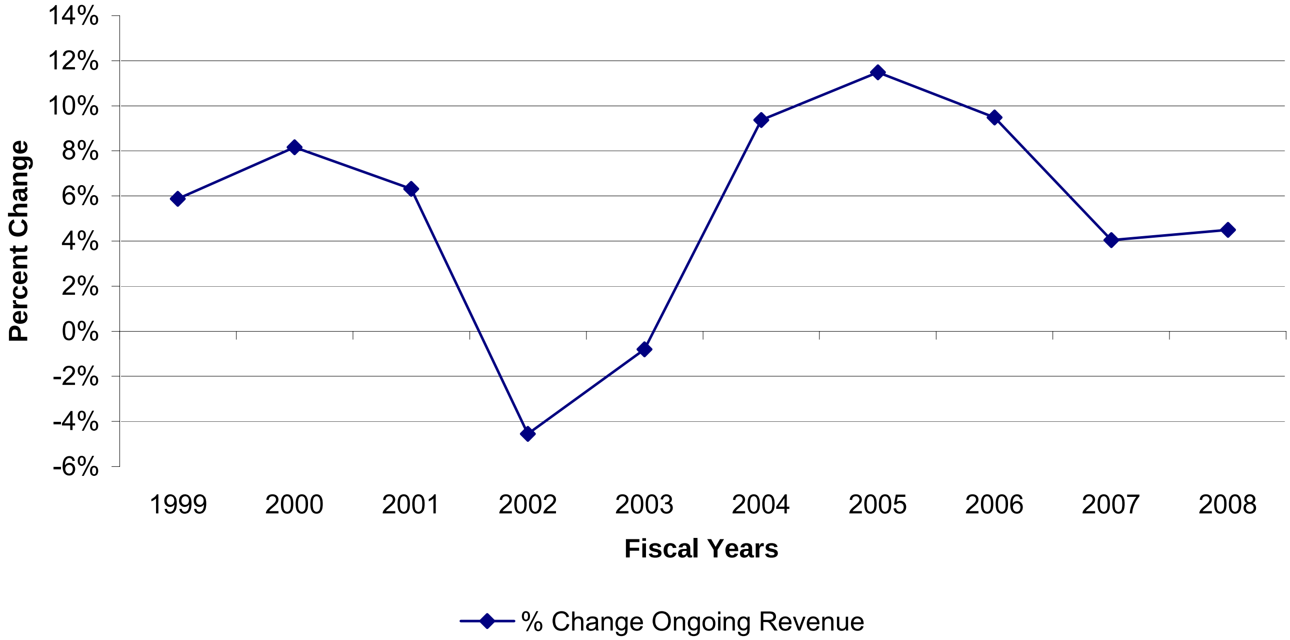
FY 2008 Ongoing Spending Growth Outpaces Ongoing Revenue Growth by Nearly 250 Percent



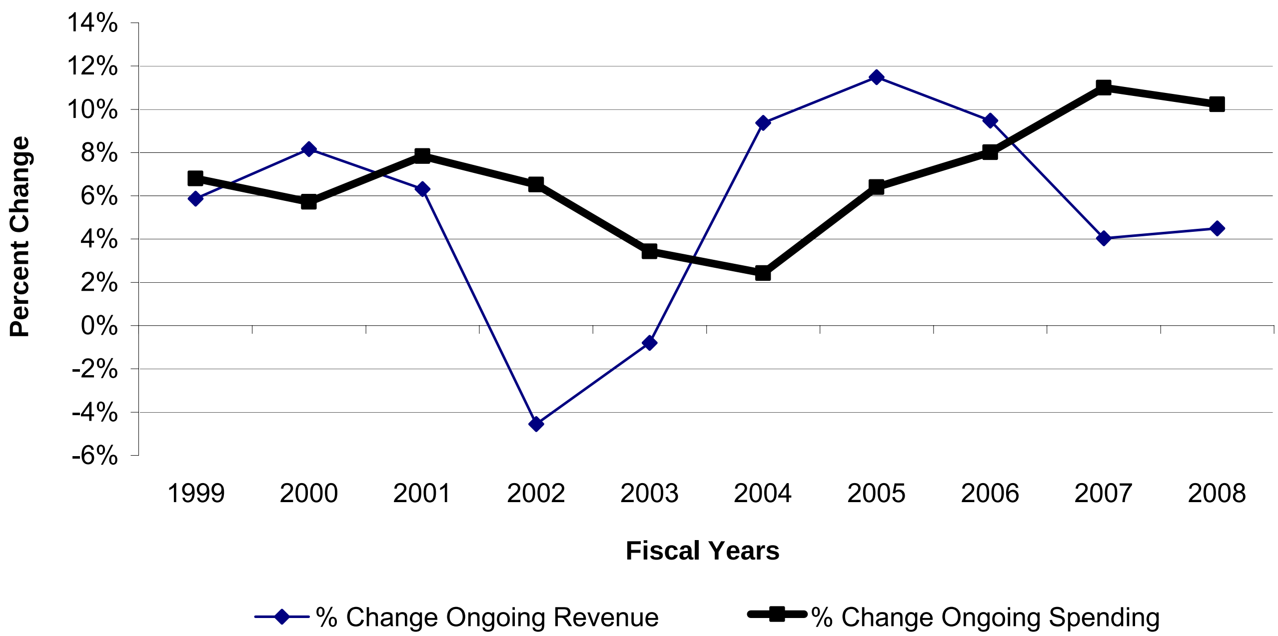
Part 4

General Fund Forecast

General Fund Revenue Patterns a.k.a. the Revenue Roller Coaster Fiscal 1999-2008



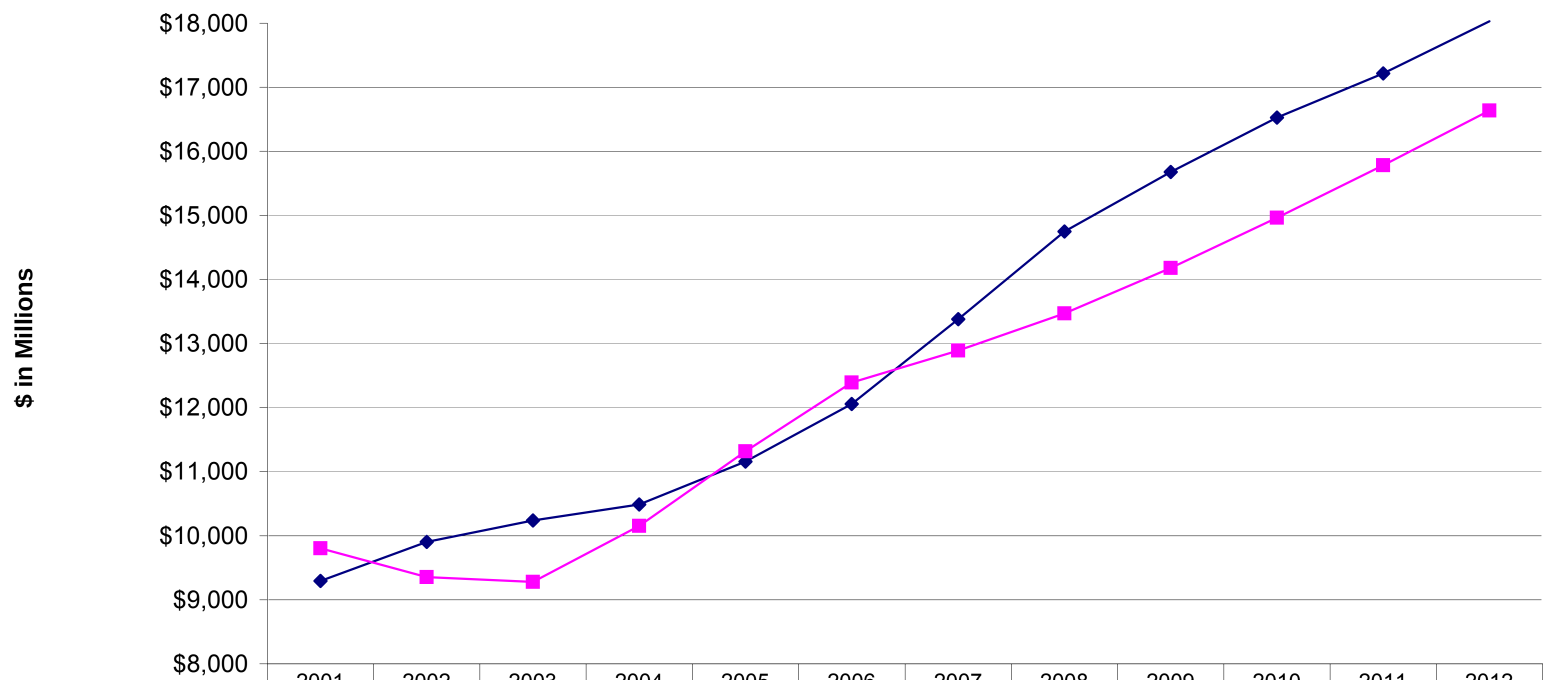
Spending Patterns Lag Revenue Changes Fiscal 1999-2008



General Fund: Recent History and Outlook
Fiscal 2004-2008
($ in Millions)

	Actual			Forecast	
	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Funds Available					
Ongoing Revenues	$10,151	$11,317	$12,390	$12,891	$13,471
Balances and Transfers	519	939	1,313	1,368	1,184
Generally Accepted Accounting Principles Transfers	-50	-37	0	150	0
Short-term Revenues	104	231	0	0	0
Subtotal Funds Available	**$10,951**	**$12,450**	**$13,703**	**$14,409**	**$14,655**
Appropriations, Deficiencies, and Cost Containment					
Net Ongoing Operating Costs and Deficiencies	$10,488	$11,159	$12,054	$13,380	$14,749
PAYGO Capital	1	1	6	136	86
Appropriations to Reserve Fund	10	115	282	656	163
Subtotal Spending	**$10,498**	**$11,275**	**$12,342**	**$14,172**	**$14,998**
Cash Balance/Shortfall	**$453**	**$1,174**	**$1,362**	**$237**	**-$343**
Structural					
Balance (Ongoing Revenues Less Operating Costs)	**-$337**	**$158**	**$336**	**-$489**	**-$1,278**
Ratio (Ongoing Revenues/Operating Costs)	**97%**	**101%**	**103%**	**96%**	**91%**
Reserve Fund Activity					
Appropriations to Rainy Day Fund	$10	$115	$282	$656	$163
Transfers to General Fund	0	-91	0	0	930
Estimated Rainy Day Fund Balance – June 30	**$497**	**$521**	**$759**	**$1,408**	**$674**
Total Cash (Rainy Day, General Fund Balance)	**$949**	**$1,696**	**$2,120**	**$1,645**	**$331**

Ongoing Revenues and Spending
Structural Gap Persists



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Ongoing Spending	$9,295	$9,901	$10,240	$10,488	$11,159	$12,054	$13,380	$14,749	$15,677	$16,525	$17,216	$18,029
Ongoing Revenues	$9,802	$9,356	$9,281	$10,151	$11,317	$12,390	$12,891	$13,471	$14,178	$14,963	$15,783	$16,634
Structural Balance	$507	-$545	-$959	-$337	$158	$336	-$489	-$1,278	-$1,499	-$1,562	-$1,433	-$1,395

Fiscal Years

General Fund Projections

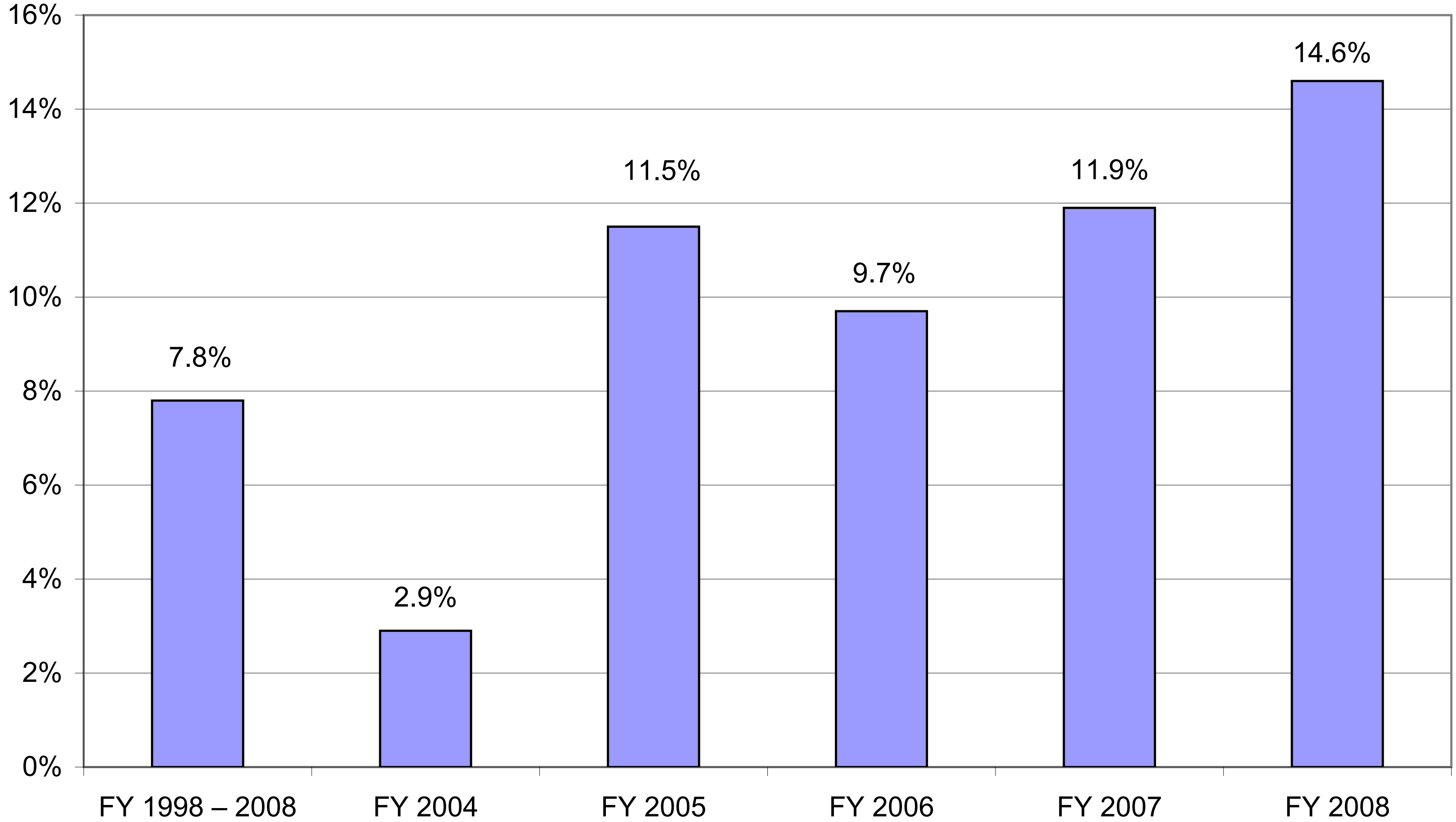
Fiscal 2007-2012

	Leg. Approp. FY 2007	Baseline FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Annual Growth Rate FY07-08	Avg. Annual Growth Rate FY 08-12
Revenues – October 2006 DLS Estimate								
Individual Income	$6,551	$6,944	$7,394	$7,898	$8,431	$8,990	6.0%	6.7%
Sales and Use	3,488	3,654	3,845	4,044	4,255	4,467	4.8%	5.2%
Lottery	480	503	518	534	551	568	4.8%	3.1%
Other	2,373	2,370	2,421	2,487	2,546	2,609	-0.1%	2.4%
One-time	150	0	0	0	0	0	n/a	n/a
Subtotal	**$13,042**	**$13,471**	**$14,178**	**$14,963**	**$15,783**	**$16,634**	**3.3%**	**5.4%**
Adjustments								
Balance	$1,362	$238	$0	$0	$0	$0	-82.6%	-100.0%
Rainy Day Fund Transfer	0	930	46	42	42	7	n/a	-70.5%
Transfers	6	17	24	24	9	0	180.1%	-100.0%
Total Revenues	**$14,409**	**$14,655**	**$14,248**	**$15,029**	**$15,833**	**$16,641**	**1.7%**	**3.2%**
Expenditures								
Debt Service	$0	$81	$112	$112	$122	$125	n/a	11.6%
Local Aid – Education\Libraries	4,535	5,345	5,620	5,879	6,082	6,305	17.9%	4.2%
Local Aid – Other	499	548	577	613	651	692	9.7%	6.0%
Entitlements	2,536	2,698	2,904	3,125	3,340	3,570	6.4%	7.2%
State Operations/Reversions	5,568	5,895	6,211	6,490	6,822	7,138	5.9%	4.9%
Deficiencies	59	0	0	0	0	0	n/a	n/a
Subtotal	**$13,197**	**$14,566**	**$15,424**	**$16,219**	**$17,016**	**$17,829**	**10.4%**	**5.2%**
Capital	$136	$86	$89	$88	$86	$86	-36.4%	0.0%
Multi-year Commitments	183	183	253	306	200	200	n/a	2.2%
Reserve Fund	656	163	50	50	50	50	-75.2%	-25.6%
Total Expenditures	**$14,172**	**$14,998**	**$15,815**	**$16,663**	**$17,352**	**$18,166**	**5.8%**	**4.9%**
Surplus (Shortfall)	**$238**	**-$343**	**-$1,568**	**-$1,634**	**-$1,519**	**-$1,524**		
Ongoing Revenues vs Operating Expenses	**-$489**	**-$1,278**	**-$1,499**	**-$1,562**	**-$1,434**	**-$1,395**		
Revenue Stabilization Fund								
Ending Balance	$1,408	$675	$710	$750	$791	$834		
As a Percent of Revenues	10.8%	5.0%	5.0%	5.0%	5.0%	5.0%		
Ratio of Operating Revenues to Expenditures	0.96	0.91	0.90	0.91	0.92	0.92		

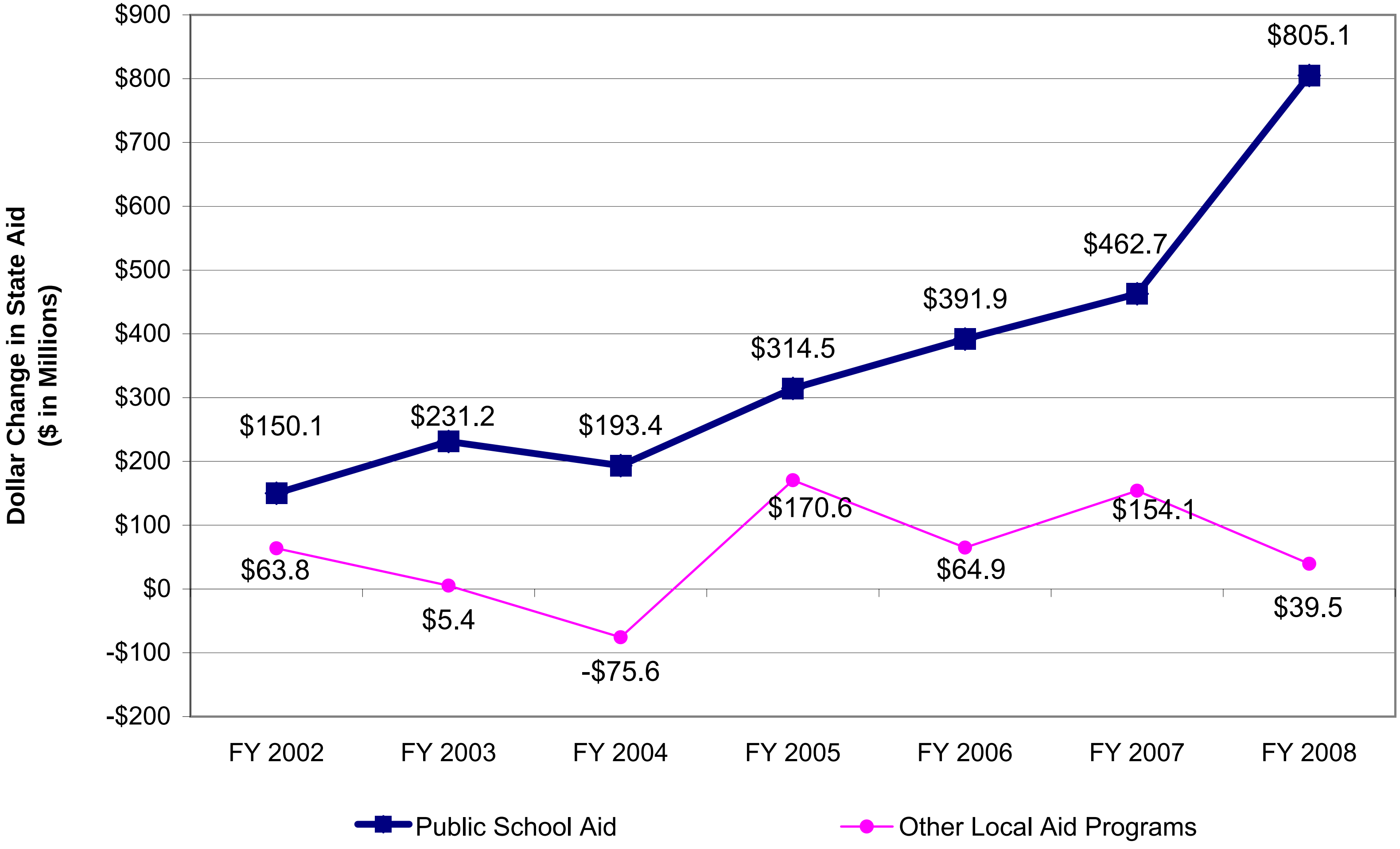
Part 5

Local Government Assistance

Annual Growth in State Aid to Local Governments
General and Special Funds



Growth in Education Aid Exceeds Other Programs
General and Special Funds
Fiscal 2002-2008



Education Aid Increases
($ in Millions)

	$ Increase	% of Increase
Inflation		
In Thornton Formulas*	$210.3	
In Teacher Salary Base	28.0	
Other Inflationary Increases	43.2	
Inflation Subtotal	**$281.5**	**35%**
Enhancements		
Fiscal 2008 Thornton Phase-in	$343.1	
Retirement	78.1	
Cost of Education Index (GCEI)	95.7	
Other Enhancements	6.7	
Enhancements Subtotal	**$523.6**	**65%**
Total Education Aid Increases	**$805.1**	

* Includes a $14.4 million increase in student transportation formula.

- Including $100 million in discretionary enhancements, State aid for primary and secondary education will increase by an estimated $805 million in fiscal 2008.

- More than one-third (35%) of the increase, a total of $282 million, is due to inflation and other cost increases.

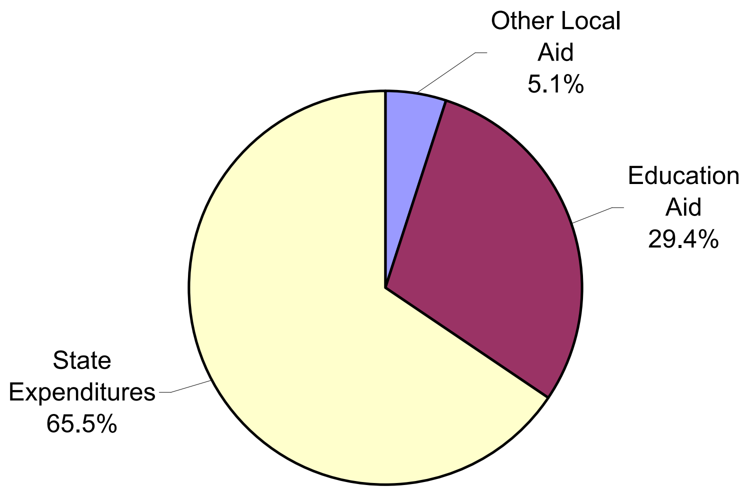
- The implicit price deflator for State and local government purchases, the inflator that drives most of the Thornton funding formulas, increased by 5.7%, nearly double the expected inflation rate. The higher-than-expected growth results in an additional $107 million in spending.

- As expected, the final year of the Thornton phase-in is responsible for the largest share of the projected fiscal 2008 increase, $343 million, or 43% of the total increase.

- After fiscal 2008, the Thornton formulas remain in place but annual increases will be driven by enrollment changes and inflation.

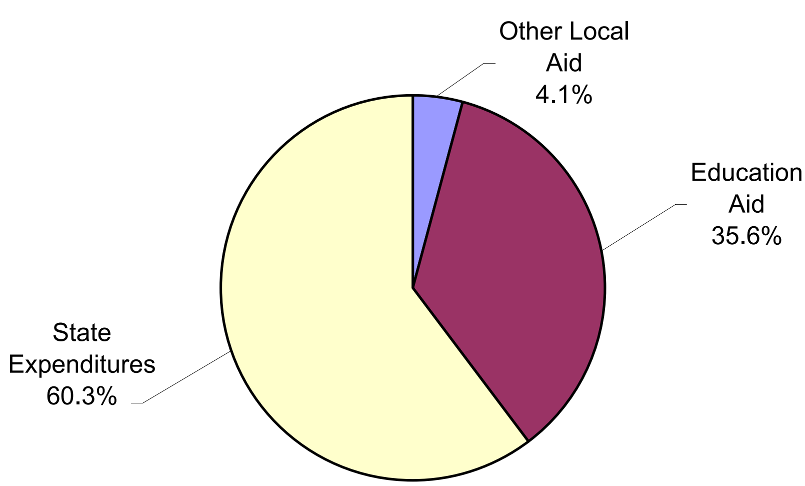
Education Aid Accounts for
Larger Share of State General Fund Expenditures

Fiscal 2003



Total General Fund Expenditures = $10.2 Billion

Fiscal 2008



Total General Fund Expenditures = $14.8 Billion

State Aid by Governmental Entity

Amount and Percent of Total
State Funds
($ in Millions)

	FY 2008 State Aid Amount	Percent of Total
Public Schools	$5,284.7	79.6%
County/Municipal	978.1	14.7%
Community Colleges	245.4	3.7%
Local Health	65.1	1.0%
Libraries	61.7	0.9%
Total	**$6,634.9**	**100.0%**

Increase in State Aid
by Governmental Entity
State Funds
($ in Millions)

	FY 2008 Aid Increase	Percent Increase
Public Schools	$805.1	18.0%
County/Municipal	-8.3	-0.8%
Community Colleges	39.5	19.2%
Local Health	2.0	3.2%
Libraries	6.3	11.3%
Total	**$844.6**	**14.6%**

State Aid by Major Programs
Fiscal 2006-2008
State Funds
($ in Millions)

	FY 2006	FY 2007	Baseline FY 2008	Difference	Percent Difference
Public Schools					
Foundation Program	$2,308.3	$2,493.2	$2,796.8	$303.6	12.2%
Compensatory Aid	600.4	726.7	898.9	172.2	23.7%
Student Transportation	187.1	202.1	219.5	17.4	8.6%
Special Education – Formula	191.3	231.8	285.6	53.8	23.2%
Special Education – Nonpublic	107.5	116.5	124.0	7.5	6.4%
Limited English Proficiency	67.8	88.8	117.9	29.1	32.7%
Guaranteed Tax Base	38.7	60.5	82.9	22.4	37.1%
Geographic Cost Index	0.0	0.0	95.7	95.7	
Other Education Programs	108.9	113.8	96.9	-16.9	-14.9%
Subtotal Direct Aid	**$3,609.9**	**$4,033.4**	**$4,718.2**	**$684.8**	**17.0%**
Retirement Payments	406.9	446.1	566.4	120.3	27.0%
Total Public School Aid	**$4,016.8**	**$4,479.5**	**$5,284.7**	**$805.1**	**18.0%**
Libraries					
Library Aid Formula	$28.0	$31.0	$33.7	$2.6	8.5%
State Library Network	14.2	15.2	16.3	1.0	6.9%
Subtotal Direct Aid	**$42.2**	**$46.2**	**$49.9**	**$3.7**	**8.0%**
Retirement Payments	8.4	9.2	11.8	2.6	28.2%
Total Library Aid	**$50.6**	**$55.4**	**$61.7**	**$6.3**	**11.3%**
Community Colleges					
Community College Formula	$154.1	$164.8	$197.4	$32.6	19.8%
Other Programs	21.7	23.5	25.6	2.2	9.2%
Subtotal Direct Aid	**$175.9**	**$188.3**	**$223.1**	**$34.8**	**18.5%**
Retirement Payments	15.7	17.6	22.3	4.7	26.8%
Total Community College Aid	**$191.6**	**$205.9**	**$245.4**	**$39.5**	**19.2%**
Local Health Grants	**$61.9**	**$63.1**	**$65.1**	**$2.0**	**3.2%**
County/Municipal Aid					
Transportation	$549.1	$592.0	$602.1	$10.1	1.7%
Public Safety	101.9	104.3	105.7	1.3	1.3%
Program Open Space/Recreation	47.0	136.4	111.1	-25.2	-18.5%
Disparity Grant	96.6	109.5	114.6	5.1	4.7%
Utility Restructuring Grant	30.6	30.6	30.6	0.0	0.0%
Other Grants	25.8	11.7	11.8	0.1	0.5%
Subtotal Direct Aid	**$851.0**	**$984.6**	**$975.9**	**-$8.6**	**-0.9%**
Retirement Payments	1.7	1.8	2.2	0.3	18.7%
Total County/Municipal Aid	**$852.6**	**$986.4**	**$978.1**	**-$8.3**	**-0.8%**
Total State Aid	**$5,173.6**	**$5,790.3**	**$6,634.9**	**$844.6**	**14.6%**

Local Government Tax Actions

Fiscal 2006 and 2007

	Fiscal 2006		Fiscal 2007	
	Increase	Decrease	Increase	Decrease
Property Taxes	0	13	0	17
Income Taxes	0	1	0	1
Recordation Taxes	1	0	0	0
Transfer Taxes	1	0	0	0
Admissions Taxes	0	0	0	1
Lodging Taxes	5	0	0	0

Local Government Salary Actions

Fiscal 2006 and 2007

	County Government		Public Schools	
COLA Amount [1]	FY 2006	FY 2007	FY 2006	FY 2007
No COLA	1	0	0	0
1% to 2.9%	6	4	4	0
3% to 3.9%	11	8	12	6
4% and Greater	6	12	8	18

	State Government		CPI – Urban Consumers	
	FY 2006	FY 2007 [2]	FY 2006	FY 2007
COLA Amount	1.50%	2.15%	3.80%	2.90%

COLA: cost-of-living adjustment

[1] The COLA amount includes market adjustments.

[2] The COLA amount for State employees in fiscal 2007 totaled $900 for employees earning $45,000 or less; $1,400 for employees earning $70,000 or more; and 2% for employees earning between $45,000 and $70,000. On average, the COLA totaled 2.15%.

Number of Counties Changing Local Tax Rates
Comparing Fiscal 2001 and 2007

	Counties with Higher Tax Rate		Counties with Lower Tax Rate	
	Number	Percent of Higher Population	Number	Percent of Lower Population
Property	5	23.0%	16	69.9%
Income[1]	6	26.9%	1	1.7%
Recordation	10	38.9%	0	0.0%
Transfer	2	3.8%	1	0.6%
Admissions	1	1.6%	0	0.0%
Lodging	11	14.8%	0	0.0%

[1] The comparison of income tax rates is from calendar 2002 and 2007.

Local Government Salary Actions in Fiscal 2007

County	County Government Generally COLA	County Government Generally Step	Board of Education Teachers COLA	Board of Education Teachers Step
Allegany[1]	3.00%	Yes	7.50%	Yes
Anne Arundel[2]	3.00%	Yes	6.00%	Yes
Baltimore City[3]	Varies	Yes	5.00%	Yes
Baltimore[4]	3.00%	Yes	5.00%	Yes
Calvert	4.00%	Yes	3.70%	Yes
Caroline[5]	7.00%	Yes	4.00%	Yes
Carroll	2.00%	Yes	3.00%	Yes
Cecil	4.00%	Yes	4.65%	Yes
Charles[6]	4.50%	Yes	5.00%	Yes
Dorchester[7]	2.50%	Yes	3.50%	Yes
Frederick	2.00%	Yes	4.50%	Yes
Garrett[8]	3.00%	Yes	7.50%	Yes
Harford[9]	3.00%	Yes	3.00%	Yes
Howard	3.00%	Yes	3.50%	Yes
Kent	4.00%	No	4.00%	Yes
Montgomery[10]	4.00%	Yes	4.00%	Yes
Prince George's[11]	2.50%	Yes	5.00%	Yes
Queen Anne's	3.25%	Yes	3.25%	Yes
St. Mary's	4.00%	Yes	3.00%	Yes
Somerset[12]	1.50%	Yes	4.00%	Yes
Talbot	5.00%	Yes	4.00%	Yes
Washington[13]	4.50%	No	4.00%	Yes
Wicomico	8.00%	No	6.00%	Yes
Worcester	4.00%	Yes	4.00%	Yes
Number Granting	24	21	24	24

Comments

[1] In Allegany County, board of education bargaining units, other than teachers, received a 5% cost-of-living adjustment (COLA).

[2] In Anne Arundel County, labor, maintenance, and clerical workers received a COLA of 2%. County school administrators received a 6% COLA; however, board of education employees represented by AFSCME received a 3% COLA, and board of education secretaries, teacher assistants, and technicians did not receive a COLA in fiscal 2007.

[3] In Baltimore City, effective January 1, 2007, firefighters and police officers will receive a 3% COLA, and managerial and professional employees will receive a 2% COLA. Employees represented by the City Union of Baltimore received a 3% COLA (effective July 1, 2006) as well as an adjustment of $0.17 per hour (effective January 1, 2007). Employees represented by AFSCME received a 4% COLA (3% effective July 1, 2006 and 1% effective January 1, 2007).

[4] In Baltimore County, police officers and firefighters received a 4% COLA. Board of education bargaining units, other than teachers, received a 3% COLA.

[5] In Caroline County, sworn police officers and public safety employees received a 3% COLA.

[6] In addition to the COLA, Charles County employees received a 5% market adjustment to their salary.

[7] In Dorchester County, school administrators received a 4% COLA and school board support staff received a 2% COLA or $500.

[8] Garrett County roads employees received an adjustment of $0.50 per hour.

[9] Harford County teachers received a 4% market adjustment plus the 3% COLA.

[10] Of the 4% COLA for Montgomery County employees, 3% was effective July 9, 2006, and 1% will be effective January 1, 2007. Firefighters (IAFF) and Fire Management employees received a 5% COLA (4% effective July 9, 2006, and 1% effective January 7, 2007).

[11] In Prince George's County, correctional officers, police officers (FOP), sheriff's officials and deputies, and fire officials and fire fighters received a 3% COLA.

[12] In addition to the 1.5% COLA in Somerset County, county employees also received a 4% salary adjustment reflecting implementation of Phase III (final) of the county's special salary scale adjustment plan. Somerset County school administrators received a 5% COLA and board of education classified employees received a 1% COLA.

[13] In Washington County, school administrators received a 6% COLA but did not receive merit/step increases. Other board of education classified employees (excluding teachers) did not receive a COLA but did receive merit/step increases.

Source: 2006 Local Government Tax Rate and Salary Action Survey & 2006 Board of Education Salary Action Survey, Department of Legislative Services, October 18, 2006

Part 6

Debt Management

State Property Taxes

Tax Rates Reduced in Fiscal 2007

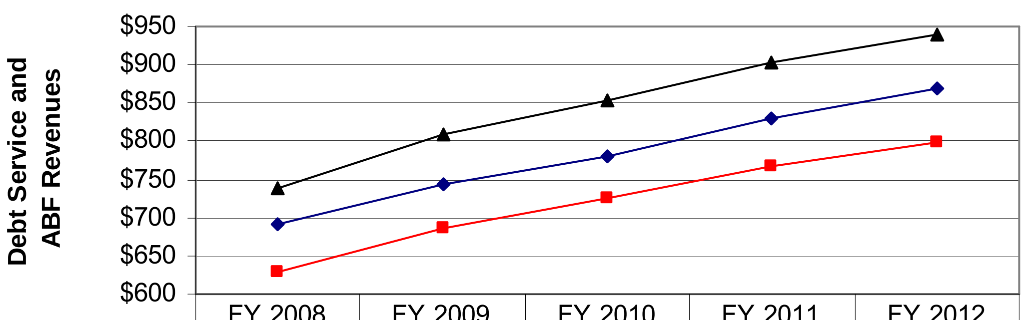
- State property taxes are deposited into the Annuity Bond Fund (ABF), which supports State General Obligation (GO) bond debt. In the past, shortfalls in the ABF were made up by appropriating general funds to support debt service payments.

- In April 2003, the Board of Public Works (BPW) raised the State property tax from $0.084 to $0.132 per $100 of assessable base. In April 2006, BPW reduced the fiscal 2007 State property tax rate to $0.112 per $100 of assessable base. This was a two-cent reduction.

- According to the State Department of Assessments and Taxation, the average sale price of a home has settled at $320,000. At this assessment, the two-cent reduction saves the average homeowner $64 in State property taxes in fiscal 2007.

- If the rate is maintained at $0.112 per $100 of assessable base, the State will need to provide a $64 million subsidy for the ABF in fiscal 2008. To fully support GO bond debt service, property taxes would need to be raised by $0.012 per $100 of assessable base in fiscal 2008.

Current State Property Tax Rate Cannot Support Debt Service
($ in Millions)



	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Debt Service	$693	$744	$781	$830	$870
ABF Support at $0.132	738	808	854	902	939
ABF Revenues After Two-cent Reduction	628	686	725	766	797
GF Support at $0.112	64	58	56	63	73

Fiscal Years

State Debt Policy

Proposed Debt Levels Meet CDAC Criteria

- The Capital Debt Affordability Committee (CDAC) advises the General Assembly on State debt policy.

- State debt includes General Obligation (GO) bonds, transportation bonds, Grant Anticipation Revenue Vehicles (GARVEEs), bay restoration bonds, stadium authority bonds, and capital leases.

- CDAC criteria are that:

  - State tax-supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and

  - State tax-supported debt service payments should not exceed 8 percent of State revenues.

- The table below shows the Department of Legislative Services' (DLS) projects that CDAC proposed authorization levels meet the affordability criteria:

Fiscal Year	Debt Outstanding as a Percent of Personal Income	Debt Service as a Percent of Revenues
2007	2.75%	5.69%
2008	2.83%	5.87%
2009	2.96%	6.09%
2010	2.94%	6.28%
2011	2.90%	6.38%
2012	2.80%	6.43%

State Debt Policy (Cont.)

Capital Debt Affordability Committee GO Bond Recommendations

- The CDAC recommends that the General Assembly authorize up to $810 million in GO bonds in the 2007 legislative session.

- This provides a $120 million increase over the authorization in the 2006 legislative session and represents a change in the committee's authorization policy.

  - The committee increased authorizations by $100 million.

  - The remaining $20 million increase was previously planned.

GO Bond Authorizations Have Increased by Over 40 Percent Since the 2001 Session

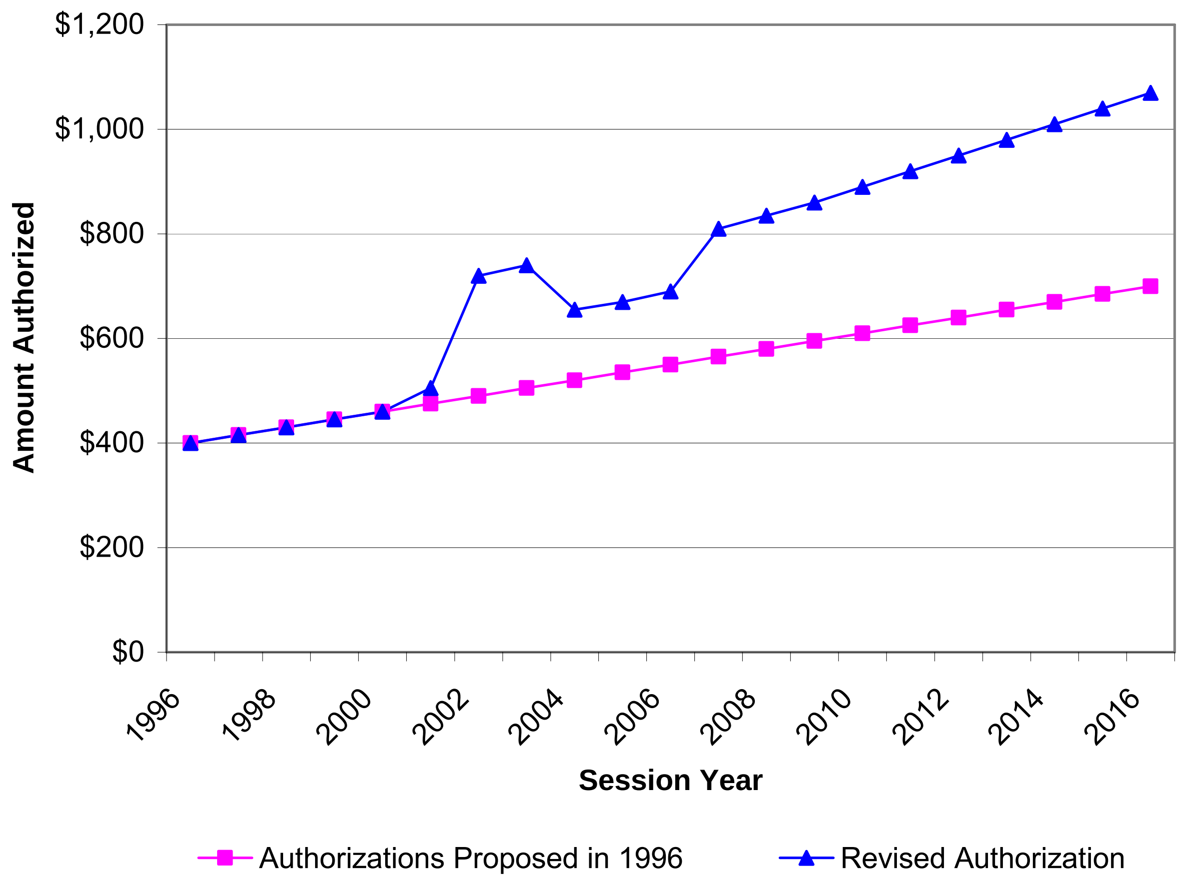
- Prior to the 2001 session, CDAC would authorize an additional $15 million in GO bonds each year.

- Beginning in the 2001 session, GO bond authorizations have increased by more than $15 million annually. Total proposed authorizations over the period increased $3.9 billion.

- If the pre-2001 policy were still in place, the 2007 session GO bond authorization limit would be $565 million, which is $245 million less than the current CDAC recommendation.

State Debt Policy (Cont.)

Increased GO Bond Authorizations
1996 to 2016 Legislative Sessions
($ in Millions)



Notes:

(1) The source for 1996 to 2006 revised authorizations is the *Sine Die Report* and *90 Day Report* data of actual authorizations.

(2) The source for 2007 to 2012 revised authorizations is the 2006 Capital Debt Affordability Committee Report's recommended authorizations.

(3) The analysis ends in 2016, the final year that the CDAC report provides a recommended authorization.

Justification for and Amount of Increased GO Bond Authorizations 2001 to 2016 Legislative Sessions ($ in Millions)

Session Year	2001 – Low CDAC Ratios & Good Economy	2002 & 2003 – Poor Economy so Replace PAYGO	2002 – Exclude Tobacco Buyout	2004 – $100 Million Annually for Five Years	2006 – Capital Demand	2007 – Capital Demand	Total Increase
2001	$30	$0	$0	$0	$0	$0	$30
2002	30	200	0	0	0	0	230
2003	30	200	5	0	0	0	235
2004	30	0	5	100	0	0	135
2005	30	0	5	100	0	0	135
2006	30	0	5	100	5	0	140
2007	30	0	5	100	10	100	245
2008	30	0	5	100	15	105	255
2009	30	0	5	0	115	115	265
2010	30	0	5	0	125	120	280
2011	30	0	5	0	135	125	295
2012	30	0	5	0	145	130	310
2013	30	0	5	0	155	135	325
2014	30	0	5	0	165	140	340
2015	30	0	5	0	175	145	355
2016	30	0	5	0	185	150	370
Total	**$480**	**$400**	**$70**	**$500**	**$1,230**	**$1,265**	**$3,945**

Note: Dates denote legislative session year. In some cases the action stems from the CDAC report recommendation from the previous fall.

State Debt Policy (Cont.)

New Kinds of State Debt Were Also Authorized

- Chapter 428 of 2004 authorized the issuance of bay restoration bonds by a newly created Bay Restoration Fund. The fund was created to support wastewater treatment plant improvements. The State plans to issue $530 million in bay restoration bonds.

- Chapter 472 of 2005 authorized the issuance of GARVEEs. An authorization to issue GARVEEs was given to support the InterCounty Connector. GARVEEs are supported by federal transportation grants. The State plans to issue $750 million in GARVEEs.

Pressures to Continue Issuing More Debt Are Still Evident

- ***Transportation Capital Program Decline:*** Once again, a sharp decline in the transportation capital program is projected. In the past, the State has avoided these declines.

- ***Potentially Underfunded Bay Restoration Fund:*** Bonds are planned to make improvements to wastewater treatment plants. Costs have been higher and revenues lower than projected. It appears that if more funds are not found, the program's goals cannot be met.

- ***Unexpected Capital Leases:*** Capital leases for real estate are used to move quickly on capital projects. Because they are often unexpected, they are not included in the CDAC debt estimates. Since these projects do happen, however irregularly, actual lease debt outstanding tends to exceed projections.

- ***Maryland Stadium Authority Projects:*** The authority has a planning process and periodically prepares feasibility studies to examine capital needs. Approving a stadium authority project could increase the demand for debt financing.

State Debt Policy (Cont.)

Unused State Debt Capacity Has Declined Since the 2006 Legislative Session
($ in Millions)

Debt Outstanding on June 30, 2009	January 2006 Estimate	November 2006 Estimate	Difference
GO Bond	$5,673	$5,705	$32
Capital Leases	180	207	28
Transportation Bonds	1,551	1,746	195
GARVEEs	606	701	95
Stadium Authority Bonds	252	284	32
Bay Restoration Bonds	178	178	0
Total Debt Outstanding	**$8,440**	**$8,821**	**$381**
Estimated Personal Income in 2009	**$291,643**	**$297,806**	**$6,163**
Unused Capacity	**$893**	**$709**	**-$183**

Recent Changes in State Personal Income Affect State Debt Capacity

- CDAC and DLS estimates of unused capacity vary by $272 million.
  - DLS unused capacity is $189 million less because DLS projects higher debt outstanding than the CDAC; and
  - DLS unused capacity is $461 million more because of DLS' higher personal income estimates.
- The key point is not so much the direction of the change in personal income but the magnitude of the change. As the State gets closer to the debt affordability limit, the volatility of personal income estimates could result in a half-billion reduction in capacity that forces the State to choose between:
  - eliminating previously planned capital spending; or
  - loosening decades-old fiscal standards and risking the AAA bond rating.

State Debt Policy (Cont.)

The Growth in State Debt May Force the State to Rethink How Capital Projects Are Funded

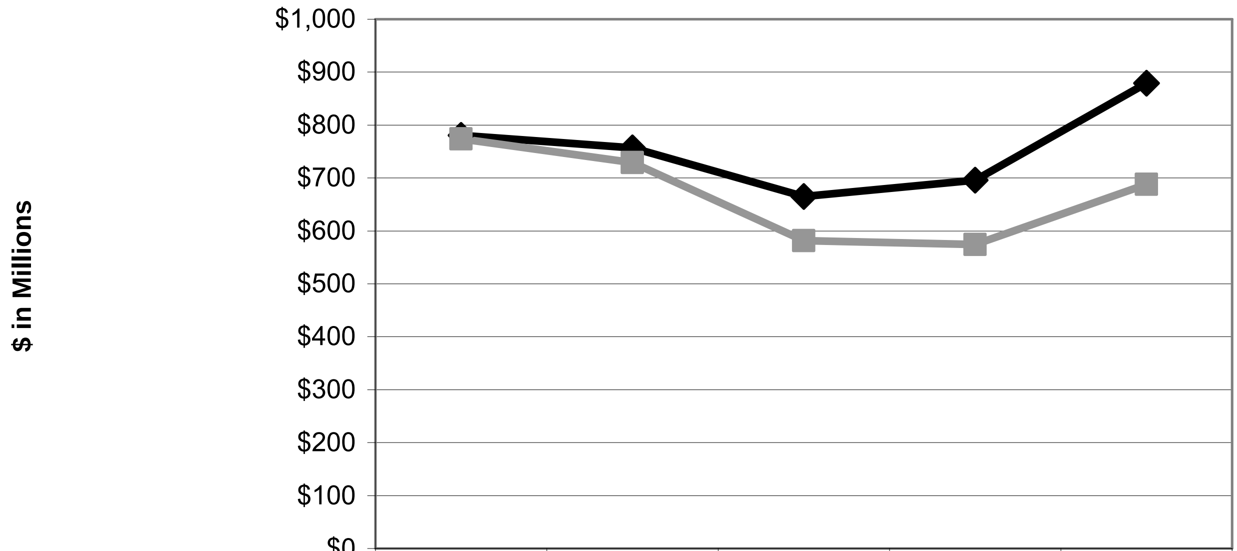
- In 2000, State debt outstanding was 77 percent of total debt capacity. Now total debt outstanding is 93 percent of capacity. This increase is attributable to:
  - aggressive increases in actual and proposed GO bond authorizations since 2001;
  - authorizations of two new kinds of debt (GARVEEs and bay bonds);
- A review of specific bond programs suggests that current estimates of non-GO debt outstanding, such as transportation and bay bonds, are more likely to be revised upward than downward; and
- As the State gets closer to the limit, volatility in personal income estimates can bring the State over the limit and force the State to eliminate previously planned capital projects.
- The analysis suggests that debt cannot grow as quickly in subsequent years as it has grown in the last six years without exceeding CDAC limits. If capital spending is to continue growing at the current rate, additional PAYGO funds will be needed to avoid exceeding the limits.

General Obligation Bond Capital Program

Escalating Construction Costs: More Amounts to Less

- Several years of elevated building construction costs coupled with declining capital appropriations have eroded the State's capital spending power.

GO and GF Capital Appropriations – Actual and Adjusted for Inflation
Fiscal 2003-2007



	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Total General & GO Funds	$780.3	$756.7	$664.9	$696.0	$878.8
Adjusted for Inflation	$774.1	$729.0	$581.8	$574.2	$688.1

Source: Fiscal 2003 through 2007 State operating and capital budgets

- Despite a fiscal 2007 funding level that exceeds each of the annual fiscal 2003 through 2006 appropriations, when adjusted for inflation, the fiscal 2007 funding level lags behind what was appropriated in fiscal 2003.

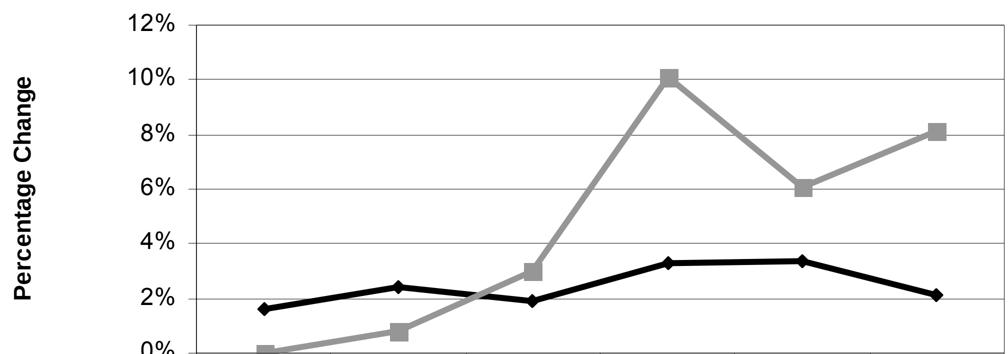
General Obligation Bond Capital Program (Cont.)

Construction Cost Inflation Exceeds General Inflation

- **Construction has experienced greater cost increases than the rest of the economy.** As shown below, beginning in 2003, the year-over-year measure for inflation in the building and construction market exceeded the general measure of inflation reflected in the consumer price index (CPI).

- Annual construction components and materials cost increases, ranging from 10 percent in calendar 2004, 6 percent in calendar 2005, and 8 percent through October 2006 have pushed construction costs up a total of 23 percent since December 2003.

Materials and Components of Construction Costs Compared to the Consumer Price Index



	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Consumer Price Index (CPI-U)	1.6%	2.4%	1.9%	3.3%	3.4%	2.1%
Materials & Components for Construction	0.0%	0.8%	3.0%	10.1%	6.1%	8.1%

Source: Bureau of Labor Statistics

- Expanding United States and global economies have created demand for many construction materials in excess of supply driving up costs.

- Fuel and transportation cost increases greatly impact construction costs and add to cost estimation uncertainty.

- Cost estimating in a volatile market is difficult and uncertainty is built into construction bids. Organizing a five-year capital improvement program is difficult under these circumstances.

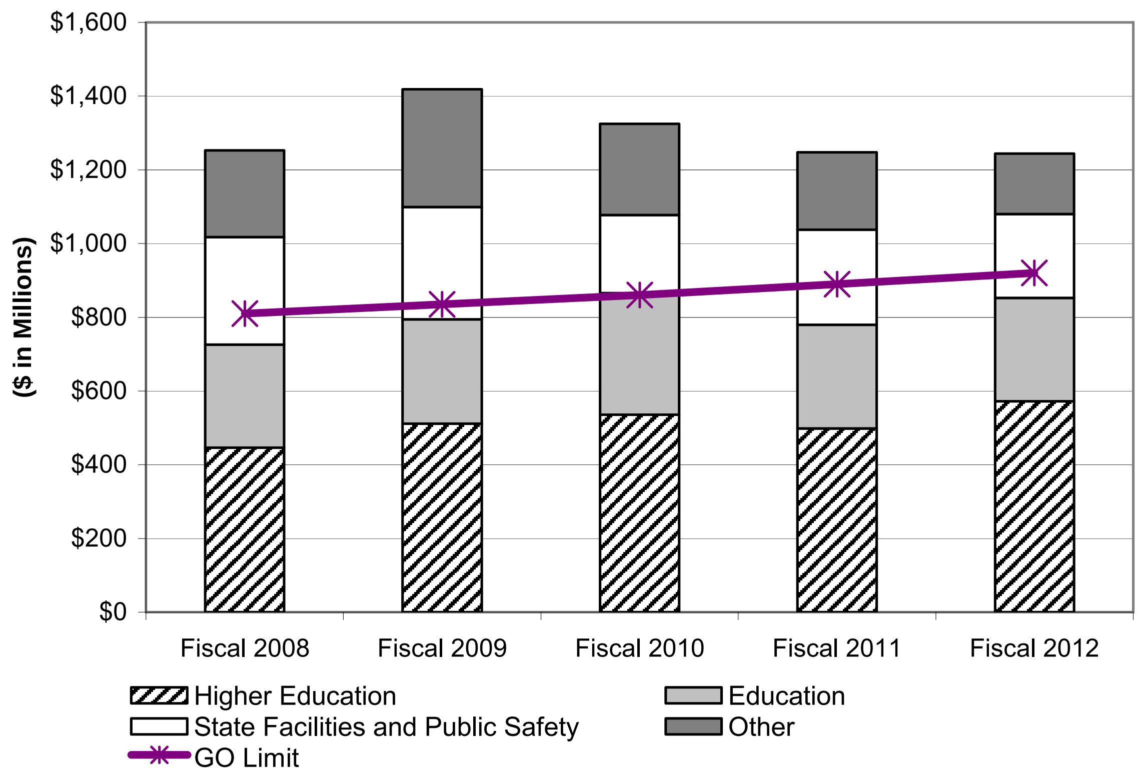
General Obligation Bond Capital Program (Cont.)

Requests Exceed Resources

- Capital GO bond requests for fiscal 2008 total $1.25 billion, over $442.8 million more than the amount available under the recommended GO bond debt limit of $810 million. Capital requests for the next five years total nearly $6.4 billion, while the projected debt limit for the same period totals about $4.3 billion.

- The next illustration indicates that the current levels of projected GO debt would just barely provide enough to fund higher education and public school construction requests. Prioritizing the State's most acute capital needs is required. **Appendix 1** provides the funding request detail by major category.

GO Bond Requests and CDAC GO Bond Debt Limit



Source: Department of Budget and Management

Impact of Projects Deferred and Accelerated

- As introduced, the fiscal 2007 capital budget deferred several projects in order to fund other budget priorities. As enacted, the capital budget also added several projects that were not scheduled to be funded in fiscal 2007. Both of these actions create additional funding demands on the fiscal 2008 capital program. The following table shows the potential fiscal 2008 budget impact of these project deferrals and accelerations is roughly $130.6 million.

Potential Fiscal 2008 Impact of Deferred and Accelerated Projects
($ in Millions)

Project	FY 2007 Planned Funding	FY 2007 Actual Funding	FY 2008 Potential Impact
Judiciary: Rockville District Court	$53.5	$0.0	$62.5
DPSCS: Maryland Correctional Training Center	24.5	0.0	30.8
DPSCS: Patuxent Institute Fire Safety Improvements	7.9	0.0	8.1
DPSCS: Western Correctional Institute Warehouse	5.6	0.0	6.6
DPSCS: Public Safety Training Center Simulated Environment	2.8	0.0	2.9
Planning: Archeology Facility	2.2	0.0	3.1
Judiciary: Cumberland District Court	2.0	0.0	0.8
University of Maryland, Baltimore: Pharmacy Hall	0.0	2.2	3.2
University of Maryland, College Park: Physical Sciences Complex	0.0	1.0	3.4
University of Maryland, College Park: New Journalism Building	0.0	10.0	5.0
Frostburg State University: Center for Communications	0.0	2.2	2.5
MD Higher Education Commission: Montgomery College Germantown Bioscience Center	0.0	1.7	1.7
Total Fiscal 2008 Impact of Projects Deferred and Accelerated			**$130.6**

Source: Department of Budget and Management

Transfer Tax Revenues Below Budgeted Estimate

- The fiscal 2007 budget included $264.5 million of estimated transfer tax revenues. Revised revenue estimates now put that figure at $240.7 million; $23.8 million below the amount upon which the fiscal 2007 budget was based.

- In accordance with applicable State law (Section 13-209, Tax Property Article), any underattainment would be reconciled in the second fiscal year following the deficiency (fiscal 2009 in this instance), or through the deauthorization of prior authorized projects.

- Although the fiscal 2007 revenue estimate is down from what was budgeted, transfer tax revenues still compare favorably to collections in recent prior fiscal years.

Fiscal 2005-2008 Estimated Transfer Tax Revenues
($ in Millions)

Fiscal Year	Original Revenue Estimate	Attainment Adjustment	Actual Collections
2005	$132.8	$104.5	$237.3
2006	194.5	75.5	270.0
2007	264.5	-23.8	240.7
2008 Est.	225.1	–	–

Note: Fiscal 2007 attainment adjustment and fiscal 2008 estimate are based on Office of the Comptroller Estimate made on October 16, 2006.

Source: Office of the Comptroller

Fiscal 2008-2012 GO Bond Capital Request

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Total	Category Totals
State Facilities							$712.6
Board of Public Works	$142.3	$194.4	$91.5	$133.1	$126.7	$688.0	
Military	9.5	3.6	0.9	2.6	0.0	16.6	
Dept. Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Health and Social Services							$527.7
Health and Mental Hygiene	$67.5	$103.8	$91.7	$17.9	$38.2	$319.1	
University of MD Medical System	12.5	22.5	20.0	15.0	25.0	95.0	
Senior Citizen Activity Center	1.3	1.5	1.5	1.5	1.5	7.3	
Juvenile Services(1)	6.3	55.0	10.0	5.0	5.0	81.3	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							$258.7
Natural Resources	$13.0	$13.0	$13.0	$13.0	$13.5	$65.5	
Agriculture(2)	5.1	7.5	7.5	8.0	8.0	36.1	
Environment	27.3	28.0	27.5	26.0	26.0	134.8	
MD Environmental Service	3.8	3.7	4.7	4.8	5.3	22.3	
Education							$1,453.3
Education	$0.0	$0.7	$50.5	$0.0	$0.0	$51.2	
MD School for the Deaf	1.5	4.2	1.6	1.1	0.0	8.4	
Public School Construction(3)	277.9	277.6	277.9	280.0	280.3	1,393.7	
Higher Education							$2,562.9
University System of MD(4)	$281.8	$211.1	$242.0	$281.4	$269.5	$1,285.8	
Baltimore City Comm. College	1.4	23.9	35.9	23.9	1.0	86.1	
St. Mary's College	2.0	7.2	25.5	1.4	45.9	82.0	
Morgan State University	23.8	92.6	81.4	77.1	69.5	344.4	
Community Colleges	125.1	163.5	125.2	101.6	173.8	689.2	
Southern MD Higher Educ. Center	0.0	1.2	13.4	0.8	0.0	15.4	
Private Facilities Grant Program	12.0	12.0	12.0	12.0	12.0	60.0	
Public Safety							$581.1
Public Safety	$79.5	$51.8	$79.6	$97.2	$97.4	405.5	
State Police	21.2	21.4	24.6	11.0	0.0	78.2	
Local Jails	37.3	31.8	14.6	12.3	1.4	97.4	
Housing and Economic Development							$81.5
Economic Development	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Housing and Comm. Development	10.5	8.0	8.0	9.0	9.0	44.5	
Canal Place	0.0	0.0	0.0	1.7	0.0	1.7	
Historic St. Mary's City	1.6	1.2	8.0	6.8	1.3	18.9	
Planning	1.4	4.4	1.3	1.4	7.9	16.4	
Legislative Initiatives	15.0	15.0	15.0	15.0	15.0	75.0	$75.0
Miscellaneous	62.6	49.4	29.0	12.0	3.5	156.5	$156.5
Subtotal Request	**$1,249.8**	**$1,416.6**	**$1,320.4**	**$1,179.2**	**$1,243.3**	**$6,409.3**	**$6,409.3**
Tobacco Transition Program	3.0	3.0	5.0	0.0	0.0	11.0	$11.0
Total Request	**$1,252.8**	**$1,419.6**	**$1,325.4**	**$1,179.2**	**$1,243.3**	**$6,420.3**	**$6,420.3**
Debt Affordability Limits	**$810.0**	**$835.0**	**$860.0**	**$890.0**	**$920.0**	**$4,315.0**	

(1) The figures above are based on the 2006 *Capital Improvement Program* .

(2) The Department of Agriculture request does not include the Tobacco Transition Program.

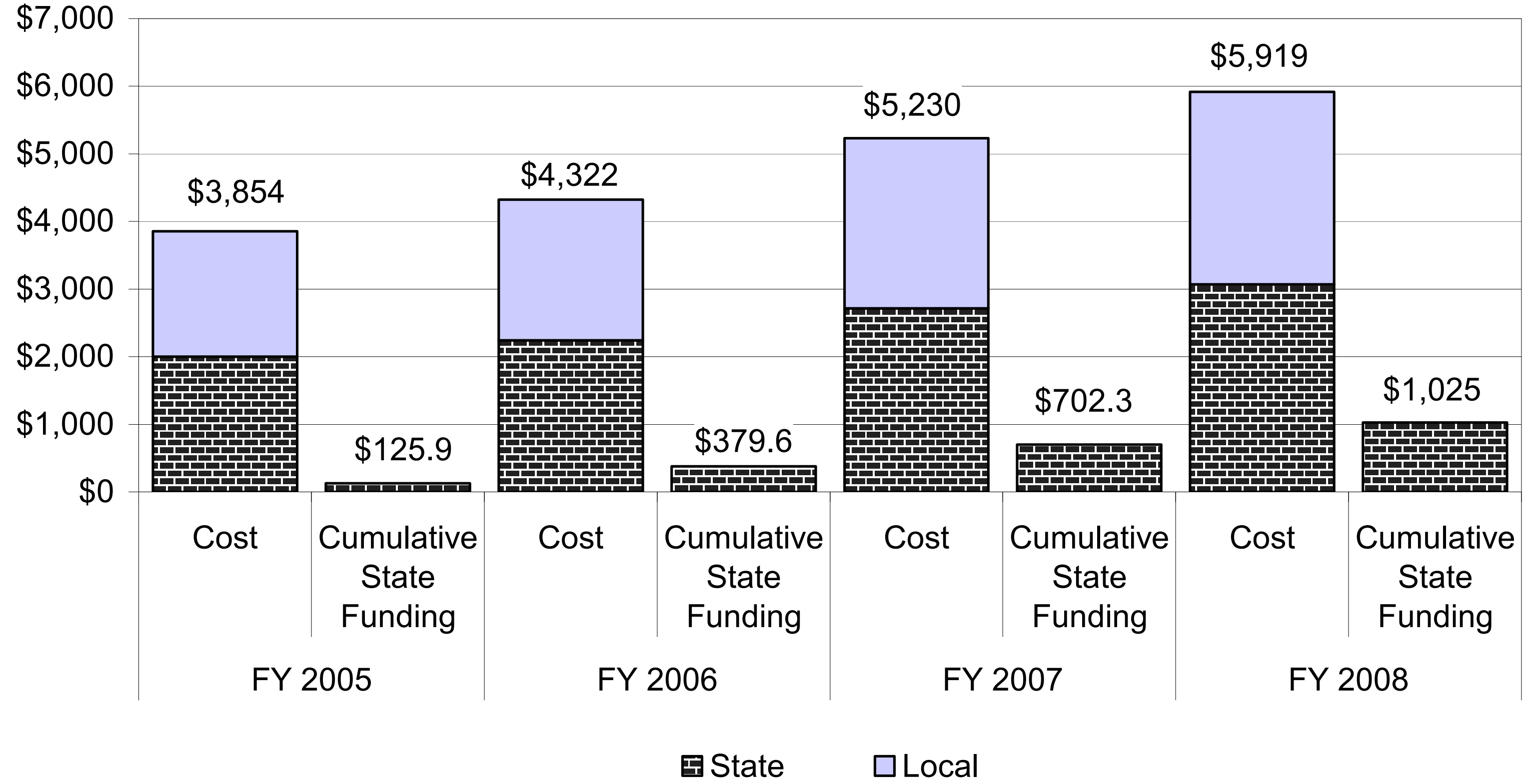
(3) The Interagency Committee on School Construction received requests in excess of $470 million for fiscal 2008; however, the amount included in the request to the Department of Budget and Management reflects base funding of $250 million plus 12 percent attributable to construction escalation.

(4) In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding of $30.0 million for fiscal 2008 and $25 million annually for fiscal 2009 through 2012.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

Total Cost to Bring School Facilities Up to Minimum Standards
($ in Millions)



	FY 2006	FY 2007	FY 2008	FY 2005-2008
% Increase in Total Cost	12.1%	21.0%	13.2%	53.6%
% Increase in State Funding	101.6%	27.2%	0.1%	156.6%

Notes: Estimated total cost based on 2003 survey of public school facilities by the Public School Construction Program (PSCP); annual cost increases reflect PSCP building cost per square foot.

Part 7

Transportation Trust Fund

Transportation Trust Fund Closeout
Comparison of Fiscal 2006 Projected and Actual Revenues
($ in Millions)

	Projected FY 2006	Actual FY 2006	Variance
Starting Fund Balance	**$245**	**$245**	**$0**
Revenues			
Titling Taxes	$742	$719	-$23
Motor Fuel Taxes	763	758	-5
Corporate Income, Registrations, Miscellaneous MVA Fees, and Rental Car Sales Taxes	744	754	10
Other Receipts and Adjustments	489	510	21
World Trade Center Sale Receipts	35	0	-35
Bond Proceeds and Premiums	105	104	-1
Total Revenues	**$2,878**	**$2,845**	**-$33**
Uses of Funds			
MDOT Operating Expenditures	$1,312	$1,303	-$9
MDOT Capital Expenditures	957	800	-157
MDOT Debt Service	141	141	0
Highway User Revenues	516	513	-3
Other Expenditures	97	94	-3
Total Expenditures	**$3,023**	**$2,851**	**-$172**
Ending Fund Balance	**$100**	**$239**	**$139**

MDOT: Maryland Department of Transportation

- Net revenues to the Transportation Trust Fund came in $33 million lower than anticipated largely due to titling tax revenues coming in $23 million less than estimated and the sale of the World Trade Center (estimated at $35 million) being postponed.

- Capital expenditures were approximately $157 million lower than anticipated. The capital program experienced cash flow changes in projects as well as higher than expected federal aid attainment which reduced the amount of special fund revenues necessary for the capital program by $13 million.

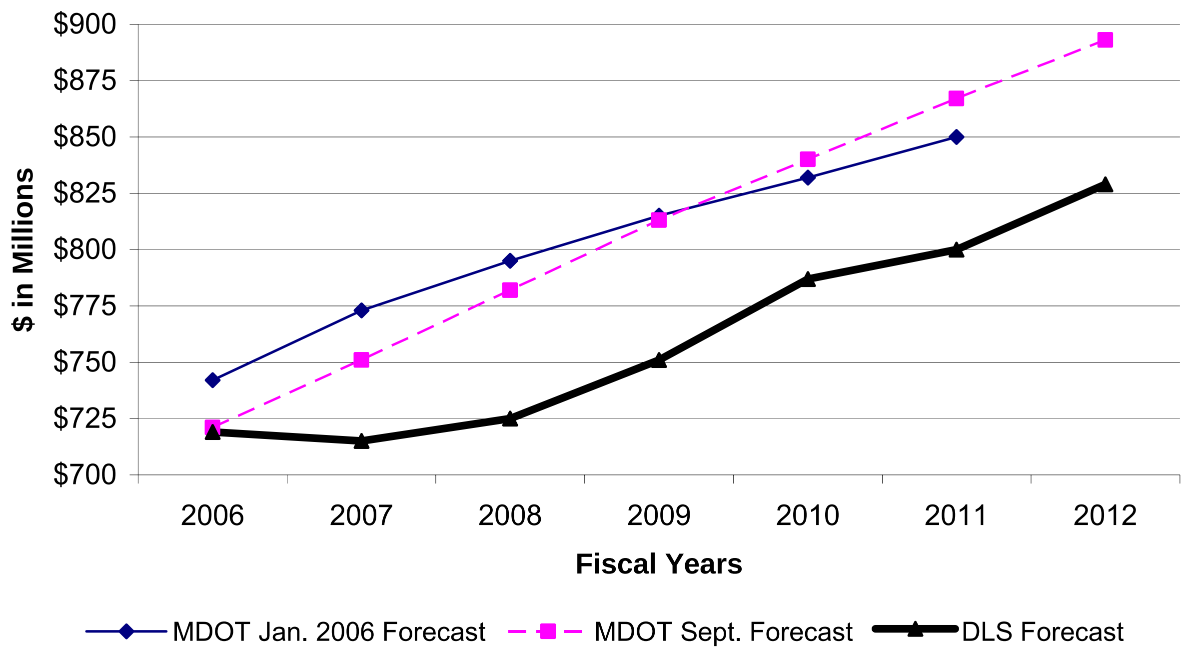
- The fiscal 2006 fund balance increased by $139 million, due mostly to capital cash flow changes which will be moved into fiscal 2007 and beyond and does not represent new funding for the capital program.

Trust Fund Forecast Assumptions

Revenue Assumptions

- A $100 million fund balance is maintained.
- Debt is capped at $2 billion outstanding and coverage ratios of 2.5 times are maintained.
- Titling tax revenues are anticipated to decline in fiscal 2007 by 0.5 percent. Over the six-year period, titling tax revenues will total $4.6 billion, roughly $340 million less than the September MDOT forecast.

Titling Tax Revenues Expected to Flatten



- Motor fuel tax revenues are expected to grow 1.0 percent in fiscal 2007 and 1.8 percent in fiscal 2008 which results in revenues being $47 million less over the six-year period compared to the September MDOT forecast.
- The $43 million transfer from the Maryland Transportation Authority (MdTA) for the Transit Initiative will end in fiscal 2007.
- Deferred plans to sell the World Trade Center removes $35 million from the forecast.

Expenditure Assumptions

- Operating expenditure growth between 3 and 7 percent for MDOT modes and includes annual cost-of-living adjustment.

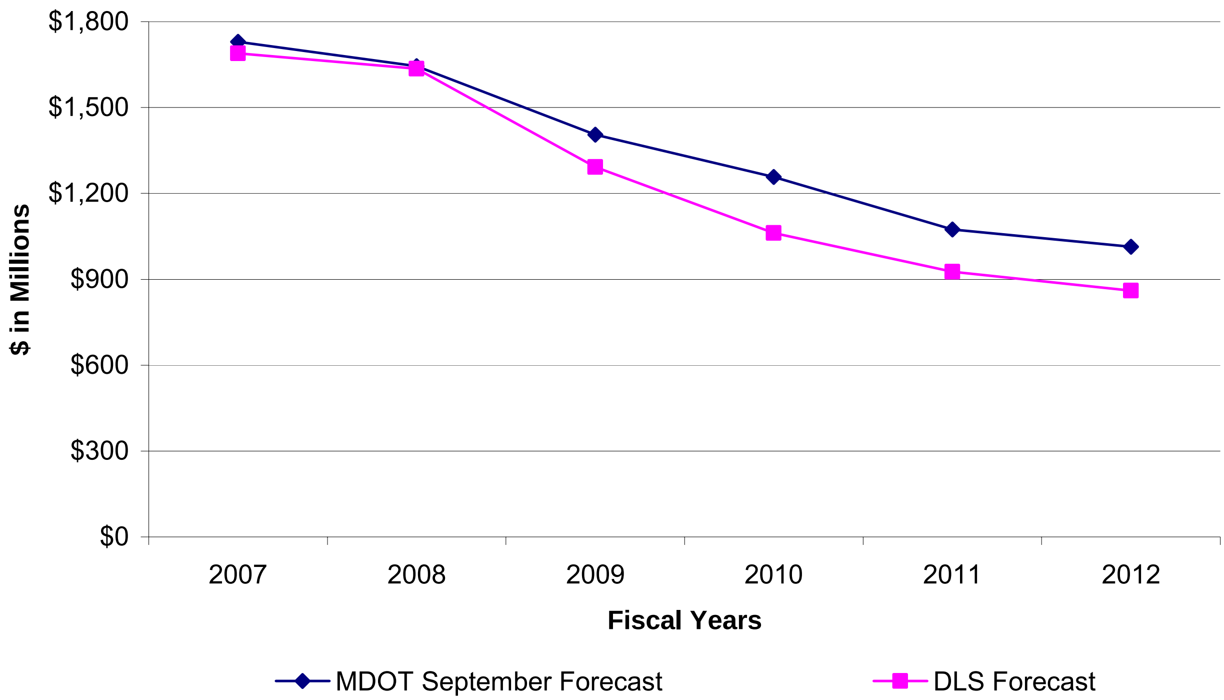
- Costs are added for the operation of the World Trade Center.

- The forecast assumes $30 million a year will be transferred to the Maryland Transportation Authority for the InterCounty Connector (ICC) from fiscal 2007 to 2010.

- GARVEE debt service payments for the ICC will begin in fiscal 2008 at $46 million, and reach $84 million by fiscal 2012.

- The total capital program, net of GARVEE debt service, will total $7.5 billion over the six-year period.

Capital Spending For Fiscal 2007-2012 Could Be $655 Million Less Than the September Estimate



- When comparing the September draft forecast to the DLS estimate, the capital program could be $655 million lower for the six-year period due primarily to downward revisions to titling motor fuel and corporate income tax revenues.

- To maintain the capital program in fiscal 2008, it is projected a bond sale of $425 million will be needed. In its September forecast, MDOT projects a $350 million bond sale in fiscal 2008.

- Due to the larger bond sale to maintain the capital program in fiscal 2008, initial debt service payments will be higher than anticipated. Future bond issuances for the capital program are constrained by the net income coverage test due to lower revenues and higher debt service payments.

- Federal fund estimates in the out-years appear to be conservative. To the extent that federal fund receipts are higher, this will help to mitigate the downward revision in revenues.

Public Private Partnerships (P3)

- P3 arrangements are a growing trend in transportation finance and represent a fundamental change in how transportation projects are constructed and maintained. Notable national examples include the Indiana Toll Road, Chicago Skyway, and Virginia Pocahontas Parkway.

- There are typically two forms of P3 agreements, with variations possible:

  - ***Concession Agreements:*** An existing State revenue generating asset (toll roads) is leased to a private entity to operate and maintain for an extended period. A lump sum payment is made to the State with the private sector collecting and retaining toll collections.

  - ***Design Build Operate Maintain:*** Similar to a concession agreement except that the private entity designs and builds a revenue generating facility for the right to collect future revenues.

- MdTA has issued a Request for Expressions of Interest (RFEI) from the private sector for the I-270/Corridor Cities Transitway project in Montgomery County. The RFEI requests input from the private sector as to what interest there may be in providing private financing for the project.

Issues

- **Weak Legal Framework:** In Maryland, there is no formal statutory framework governing P3 projects or agreements. The current legal framework for a P3 consists of regulations, existing procurement law, and an Attorney General opinion.

- **Lack of Legislative Oversight:** Currently, neither statute nor regulation provide for General Assembly approval of P3 projects, although MdTA must submit a P3 contract or agreement to the Board of Public Works for approval.

- **Role of the Private Sector:** The public sector is motivated by providing goods and service to the public whereas the private sector is motivated by market and economic forces. How these differing motivations can work together is an important consideration.

Transportation Trust Fund Forecast
Fiscal 2007-2012

	Actual Year 2006	Current FY 2007	Est. FY 2008	Est. FY 2009	Est. FY 2010	Est. FY 2011	Est. FY 2012
Opening Fund Balance	**$245**	**$239**	**$106**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$239**	**$106**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,614	$1,626	$1,665	$1,710	$1,760	$1,789	$1,832
Operating and Miscellaneous	465	450	454	470	477	490	523
Transfers between TTF and General Fund (GF)	50	0	0	0	0	0	0
MdTA Transfer	5	13	-30	-30	-30	0	0
Subtotal Net Revenues	***$2,134***	***$2,089***	***$2,089***	***$2,150***	***$2,207***	***$2,279***	***$2,355***
Bonds Sold	100	235	425	220	100	65	40
Bond Premiums	4	0	0	0	0	0	0
Total Revenues	**$2,238**	**$2,324**	**$2,514**	**$2,370**	**$2,307**	**$2,344**	**$2,395**
Expenditures							
Debt Service	$141	$118	$137	$157	$166	$175	$195
Operating Budget	1,303	1,392	1,467	1,513	1,572	1,634	1,701
State Capital	800	947	916	700	569	534	498
Total Expenditures	**$2,244**	**$2,457**	**$2,520**	**$2,370**	**$2,307**	**$2,343**	**$2,394**
Debt							
Debt Outstanding	$1,078	$1,246	$1,602	$1,746	$1,766	$1,741	$1,669
Debt Coverage – Net Income	5.5	4.5	3.0	2.7	2.5	2.5	2.5
Local Highway User Revenues	**$561**	**$561**	**$571**	**$586**	**$602**	**$612**	**$624**
Transferred to GF	49	0	0	0	0	0	0
Net HUR to Counties	**$513**	**$561**	**$571**	**$586**	**$602**	**$612**	**$624**
Capital Summary							
State Capital	$800	$947	$916	$700	$569	$534	$498
Net Federal Capital (Cash Flow)	721	746	720	592	493	392	362
Subtotal Capital Expenditures	**$1,521**	**$1,693**	**$1,636**	**$1,292**	**$1,062**	**$926**	**$860**
GARVEE Debt Service	0	0	46	52	85	84	84

Part 8

State Employment

Regular Full-time Equivalent Positions
Fiscal 2002 and 2007 Working Appropriation

Department/Service Area	FY 2002 Actual	FY 2007 Wkg. Approp.	Change	% Change
Legislative Branch	730	744	14	1.9%
Judicial Branch	3,010	3,397	388	12.9%
Subtotal	***3,740***	***4,141***	***402***	***10.7%***
Human Resources[1]	8,273	7,021	-1,251	-15.1%
Health & Mental Hygiene	8,536	7,656	-880	-10.3%
Transportation	9,538	9,021	-518	-5.4%
Natural Resources	1,629	1,369	-261	-16.0%
Labor, Licensing, & Regulation	1,706	1,475	-231	-13.6%
Public Safety & Correctional Services	11,663	11,503	-160	-1.4%
General Services	793	636	-157	-19.8%
Housing & Community Development[1]	449	316	-133	-29.6%
Financial & Revenue Administration	2,158	2,026	-133	-6.1%
Police & Fire Marshal	2,590	2,472	-118	-4.6%
Budget & Management	524	442	-82	-15.7%
Environment	1,028	951	-77	-7.5%
Agriculture	480	436	-45	-9.3%
Juvenile Services	2,123	2,080	-43	-2.0%
Business & Economic Development	324	292	-32	-9.9%
Retirement	194	189	-5	-2.3%
Executive & Administrative Control[1]	1,619	1,664	45	2.8%
Legal[1]	1,381	1,586	205	14.9%
MSDE and Other Education[1]	1,955	2,198	243	12.4%
Non-higher Education Executive Branch Subtotal	***56,961***	***53,329***	***-3,632***	***-6.4%***
Higher Education	21,386	22,783	1,397	6.5%
Total	**82,087**	**80,254**	**-1,833**	**-2.2%**

[1]The Department of Human Resources' workforce was reduced in size due to the transfer of 198 positions in the Child Care Administration to MSDE in fiscal 2006. There was also a large reduction in the workforce at Housing and Community Development when the Cultural and Historic Programs transferred to the Maryland Department of Planning in the same year. The Office of the Public Defender's workforce has increased due to the Caseload Initiative.

Regular Full-time Equivalent Filled Positions
Fiscal 2002 and 2007 Working Appropriation

Department/Service Area	FY 2002 Wkg. Approp.	FY 2007 Wkg. Approp.	Change	% Change
Legislative Branch	718	725	7	1.0%
Judicial Branch	2,882	3,233	352	12.2%
Subtotal	***3,600***	***3,958***	***359***	***10.0%***
Executive Branch				
Human Resources	7,560	6,549	-1,011	-13.4%
Health & Mental Hygiene	7,642	6,960	-682	-8.9%
Transportation	8,940	8,457	-483	-5.4%
Public Safety & Correctional Services	10,688	10,426	-262	-2.5%
Natural Resources	1,446	1,252	-193	-13.4%
Labor, Licensing, & Regulation	1,531	1,371	-160	-10.4%
Financial & Revenue Administration	2,034	1,884	-150	-7.4%
Housing & Community Development	409	294	-115	-28.1%
Police & Fire Marshal	2,410	2,320	-90	-3.7%
Budget & Management	463	389	-74	-16.1%
Environment	947	873	-74	-7.8%
General Services	663	597	-66	-9.9%
Agriculture	442	401	-41	-9.4%
Business & Economic Development	309	277	-32	-10.3%
Retirement	179	174	-5	-2.8%
Executive & Administrative Control	1,467	1,506	39	2.7%
Legal	1,290	1,459	168	13.1%
MSDE and Other Education	1,844	2,022	178	9.6%
Juvenile Services	1,454	1,914	460	31.7%
Non-higher Education Executive Branch Subtotal	***51,716***	***49,122***	***-2,593***	***-5.0%***
Higher Education	20,281	21,562	1,281	6.3%
Total	**75,596**	**74,642**	**-954**	**-1.3%**

Vacant Positions, Turnover Rate, and Necessary Vacancies
Fiscal 2007 Working Appropriation

Department/Service Area	Turnover Rate	Necessary Vacancies	Vacancy Rate	Vacant Positions[1]	Funded Vacancies/ (Unfunded Filled)
Legislative	1.5%	11	2.6%	19	8
Judiciary	3.3%	111	4.8%	164	53
Executive Branch					
Legal (no Judiciary)	5.8%	92	8.0%	128	36
Executive and Administrative Control	3.6%	60	9.5%	158	98
Financial and Revenue Administration	3.9%	79	7.0%	141	63
Budget and Management	3.6%	16	12.0%	53	37
Retirement	4.9%	9	8.2%	16	6
General Services	4.6%	29	6.1%	39	10
Transportation	4.6%	418	6.3%	564	146
Natural Resources	3.9%	53	8.5%	116	63
Agriculture	5.3%	23	8.0%	35	12
Health and Mental Hygiene	5.4%	413	9.1%	696	283
Human Resources	4.2%	297	6.7%	472	175
Labor, Licensing, and Regulation	4.4%	65	7.0%	103	38
Public Safety and Correctional Services	7.2%	831	9.4%	1,077	246
MSDE and Other Education	7.2%	157	8.0%	176	19
Housing and Community Development	3.0%	9	7.0%	22	13
Business and Economic Development	4.0%	12	5.1%	15	3
Environment	3.8%	36	8.2%	78	42
Juvenile Services	5.7%	119	8.0%	166	47
Police and Fire Marshal	4.9%	120	6.2%	152	32
Subtotal	***5.1%***	***2,960***	***7.6%***	***4,390***	***1,430***
Higher Education	3.9%	867	5.4%	1,222	354
Total	**4.6%**	**3,827**	**7.0%**	**5,612**	**1,784**

[1] The number of vacancies are as of November 1, 2006, with the exception of those in the University System of Maryland, which are as of September 30, 2006.

The State Workforce: Considerations for Fiscal 2008

- **Child Welfare:** The Child Welfare Workforce Initiative (Chapter 544 of 1998) requires the Department of Human Resources to develop a plan to hire sufficient staff to meet caseload to staff standards recommended by the Child Welfare League of America (CWLA). The fiscal 2008 baseline includes 191 new child welfare caseworker, supervisor, and support positions which are needed to bring the caseload to staff ratios within the levels recommended by the CWLA.

- **Mental Hygiene Administration:** During the fourth quarter of fiscal 2008, the State plans on opening a 44-bed wing addition to Clifton T. Perkins, the State's maximum security psychiatric hospital, requiring 136 positions.

- **Maryland State Department of Education:** Chapter 431 of 2004 requires the Maryland State Department of Education to assume responsibility for all educational programs in the Department of Juvenile Services residential facilities by July 1, 2012; in the fiscal 2008 baseline, this means the potential addition of 18 positions in the Thomas Waxter Children's Center and the J. DeWeese Carter Youth Facility to reflect the phase-in of the legislation.

- **Why Are More Positions Not Being Filled?:** There are about 1,800 vacant positions in the fiscal 2007 budget for which there is funding, including about 350 in higher education. The high number of funded vacant positions suggests that agencies are unable or unwilling to fill them, possibly holding these or other positions open to cover expenditures not related to personnel.

How Has State Employee Health and Prescription Coverage Changed in the Last Two Years?

- Beginning in January 2005, the Department of Budget and Management implemented a number of changes including:

  - increasing primary doctor's office visit copayments from $5 to $15 for POS and HMO plans and increasing specialist doctor's office visit copayments from $10 or $20 to $25 for all types of plans;

  - increasing emergency room hospital charge copayments from $25 to $50 if emergency criteria are not met and implementing physician's charge copayments of $50 per emergency room visit; and

  - covering up to 50 rather than 100 visits per year of physical therapy.

- Program restructuring in fiscal 2006 included:

  - increasing the point-of-service health insurance copremiums from 15 to 17 percent of the total cost;

  - increasing prescription copayments to $5 for generic drugs, $15 for preferred brand name drugs, and $25 for non-preferred brand name drugs from $3, $5, and $10 for the three existing tiers;

  - implementing a $700 spending cap per family for prescriptions;

  - requiring two copayments instead of one copayment for 90 days of medication;

  - implementing a 30-day maximum for the first fill of a new drug;

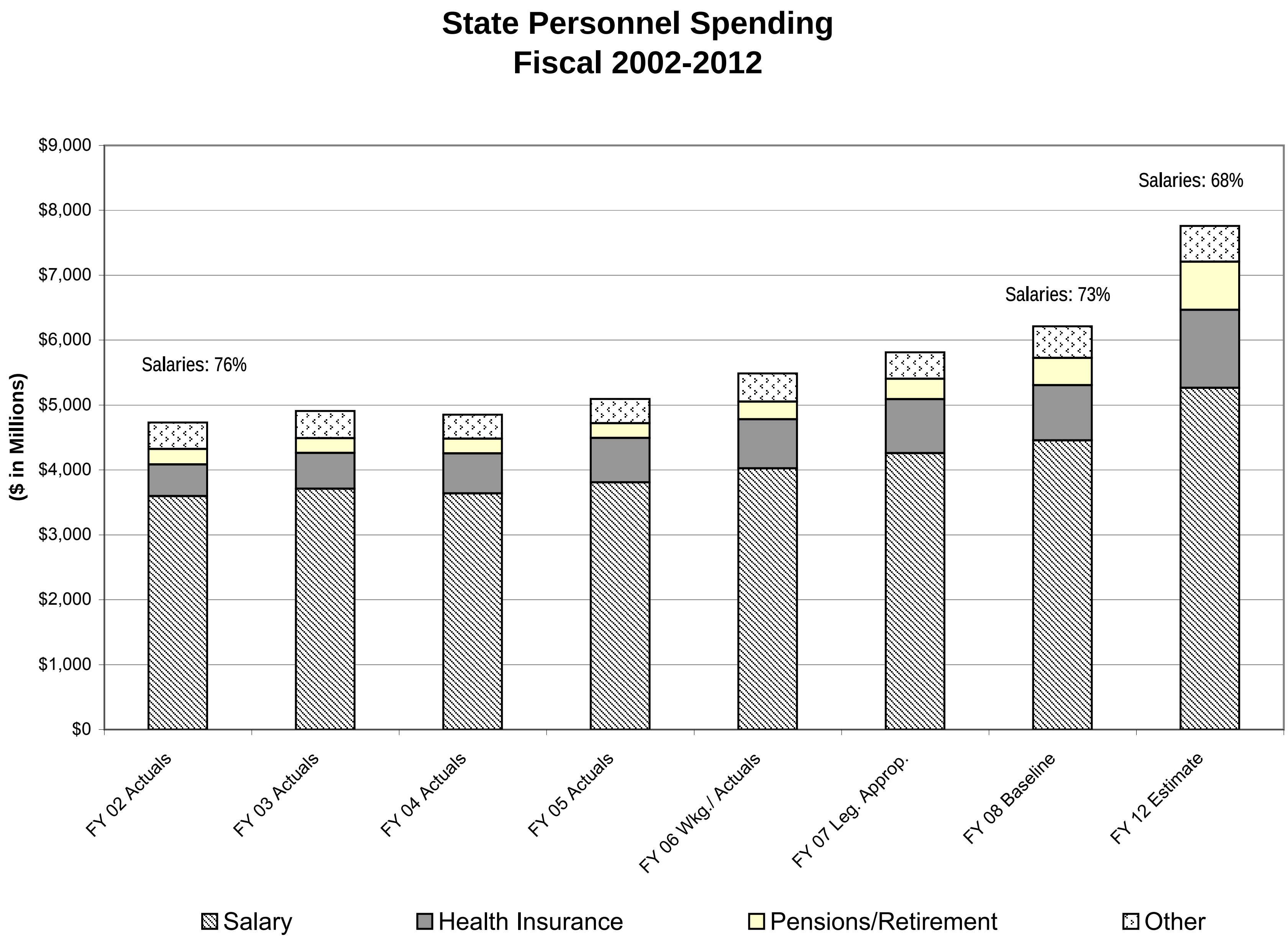
  - requiring prior authorization for certain medications; and

  - implementing a number of other changes such as required step therapy, managed quantities of drugs, and voluntary mail order and specialty drug pharmacies.

- Program restructuring in fiscal 2007 includes implementing a maximum $20 copayment in the voluntary mail order prescription program for prescriptions written for up to 90 days.

What Is Going on with Health Insurance Spending?
Fiscal 2005-2008

Claims Costs	**FY 2005**	**FY 2006**	**FY 2007 Est.**	**% Change FY 06-07**	**FY 2008 Est.**	**% Change FY 07-08**
Medical	$541.8	$584.9	$629.2	7.6%	$677.3	7.6%
Dental	25.8	30.3	31.8	4.9%	33.4	4.9%
Prescription	303.4	262.8	285.2	8.5%	309.4	8.5%
Administration	5.6	5.6	7.0	23.8%	7.3	5.0%
Increased Workforce Participation			9.5		19.7	107.8%
Total	**$876.7**	**$883.7**	**$962.6**	**8.9%**	**$1,047.0**	**8.8%**
Agencies' Payments	$705.8	$771.6	$814.1			
Enrollees' Payments	177.3	196.9	198.2			
Agency Balance		14.7				
Medicare Part D			27.2			
Total	**$883.2**	**$983.2**	**$1,039.5**			
Difference	**$6.5**	**$99.5**	**$76.9**			
Closing Account Balance	**$93.6**	**$193.1**	**$270.0**			


State Personnel Spending
Fiscal 2002-2012
$9,000
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
($ in Millions)
Salaries: 76%
Salaries: 73%
Salaries: 68%
FY 02 Actuals
FY 03 Actuals
FY 04 Actuals
FY 05 Actuals
FY 06 Wkg./ Actuals
FY 07 Leg. Approp.
FY 08 Baseline
FY 12 Estimate
Salary
Health Insurance
Pensions/Retirement
Other

Contractual Full-time Equivalent Positions
Fiscal 2002, 2006 Working Appropriation, and 2007 Legislative Appropriation

Department/Service Area	FY 2002 Actual	FY 2006 Wkg. App.	FY 2007 Leg. Approp.	FY 02-06 Change FTEs	FY 02-06 Change %	FY 06-07 Change FTEs	FY 06-07 Change %
Judiciary	371	371	368	0	0.0%	-4	-0.9%
Executive Branch							
Legal	99	111	114	12	11.9%	4	3.2%
Executive & Administrative Control	208	179	171	-30	-14.3%	-8	-4.3%
Financial & Revenue Administration	35	36	34	1	2.7%	-2	-4.4%
Budget & Management	33	12	16	-21	-63.9%	4	33.3%
Retirement	30	30	27	0	-1.1%	-3	-8.5%
General Services	35	27	26	-8	-23.5%	0	-0.3%
Transportation	142	159	177	16	11.5%	19	11.6%
Natural Resources	332	342	432	10	2.9%	91	26.5%
Agriculture	36	40	37	5	13.2%	-3	-8.4%
Health & Mental Hygiene	409	472	478	63	15.4%	6	1.3%
Human Resources	111	135	141	24	22.0%	6	4.4%
Labor, Licensing, & Regulation	176	177	194	1	0.7%	17	9.4%
Public Safety & Correctional Services	298	462	426	164	55.1%	-37	-8.0%
MSDE and Other Education	218	212	222	-6	-2.9%	10	4.8%
Housing & Community Development	49	38	43	-11	-22.6%	5	13.5%
Business & Economic Development	49	32	35	-17	-33.9%	3	9.3%
Environment	32	45	35	12	37.8%	-10	-22.5%
Juvenile Services	119	243	139	124	104.1%	-104	-42.9%
Police & Fire Marshal	46	45	50	-1	-2.6%	5	12.1%
Non-higher Education Executive Branch Subtotal	***2,457***	***2,795***	***2,797***	***338***	***13.7%***	***3***	***0.1%***
Higher Education	6,079	5,892	5,880	-187	-3.1%	-13	-0.2%
Total	**8,907**	**9,058**	**9,045**	**151**	**1.7%**	**-13**	**-0.1%**

Retiree Health Care Liabilities
Shown on State's Financial Statement in Fiscal 2008

- Governmental Accounting Standards Board (GASB) Statement No. 45 will require the State to apply an accounting methodology similar to the one used for pension liabilities to Other Post Employment Benefits (OPEB), including retiree health benefits, beginning in fiscal 2008.

- Actuarial valuation of retiree health liabilities performed by AON Consulting estimated the unfunded actuarial accrued liability for retiree health benefits to be approximately $20.4 billion. Under the GASB 45 standards, this will result in an Annual Required Contribution (ARC) amount of $1.96 billion. Any amount of the ARC that the State does not pay in a fiscal year will appear on the State's financial statement as a Net OPEB Obligation (NOO).[1]

- If the State establishes a mechanism to prefund liabilities similar to the pension system, to the extent the State pays into the fund, the State can use a similar long-term investment return assumption (7.75 percent) as opposed to the return on other State investments (5 percent).

Discount Rate	5.0% ($ Billions)	7.75% ($ Billions)
Actuarial Accrued Liability for Retiree Health Benefits	$20.4	$13.0
Annual Required Contribution Amount	1.9	1.4
Net OPEB Obligation (on Financial Statement)	1.6	1.1

[1] Because the ARC incorporates AON's estimate of approximately $311 million in costs that the State would have paid for retiree benefits on a pay-as-you-go (PAYGO) basis, if no additional contributions are made, the NOO shown on the State's financial statement would be $1.65 billion.

- ***Funding Normal Cost Recommendation:*** The task force recommended that the State set a goal of funding normal costs for retiree health benefits beginning in fiscal 2008 by setting aside approximately one-half of the total funds required to meet this goal in both the fiscal 2007 and 2008 budgets. AON's estimated normal/service cost for fiscal 2008 was $650 million, of which it is estimated that the State would already be paying approximately $320 million for current retiree health PAYGO costs. Of the remaining $329 million necessary to meet normal costs, $209 million would be general funds and $120 million would be special funds/federal funds.

  In response to the recommendation of the task force, in the fiscal 2007 budget, the Governor included $100 million in the Dedicated Purpose Account for retiree health care liabilities.

Pension Contribution Rates and Corridor Funding

- Chapter 440 of 2002 established what is known as the "corridor method" of pension funding. By this method, the contribution rates for the Employees' and Teachers' pension systems are frozen at 2002 levels, so long as the systems remain actuarially funded between 90 and 110 percent inclusive. Once a system “falls outside” the corridor, there is an increase in the contribution rate equal to 20 percent of the true actuarial rate for that year.

- The Employees and Teachers’ systems both remain out of the corridor with actuarial funding levels at the end of fiscal 2006 of 80.6 and 84.2 percent, respectively. Pension enhancements adopted in the 2006 session have resulted in an increased employer contribution of approximately $115 million as well as a decrease in the funded status of both systems.

($ in Millions)

Plan	FY 2006 Rate	FY 2007 Rate	FY 2008 Rate	Actuarial Funding Level	Budget Increase due to 2006 Enhancement	FY 2008 Budget Increase
Corridor-funded Plans						
Employees	5.76%	6.83%	8.86%	84.2%	$32.7	$65.7
Teachers	9.35%	9.71%	11.60%	80.6%	82.6	125.2
Non-corridor-funded Plans						
State Police	8.22%	13.83%	13.00%	98.2%	n/a	1.8
Judges	41.12%	42.43%	44.12%	77.6%	n/a	1.5
Law Enforcement Officers’ Pension System	38.47%	40.60%	41.74%	62.8%	n/a	0.5
Aggregate	**8.46%**	**9.18%**	**11.10%**	**87.8%**	**$115.3**	**$194.7**

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

Source: Segal Company

Part 9

Revenue Stabilization Account

State Reserve Fund Activity
Fiscal 2007 and 2008
($ in Millions)

	Rainy Day Fund	Dedicated Purpose Acct.	Catastrophic Event Acct.	Joseph Fund Acct.
Estimated Balances 6/30/06	**$758.8**	**$30.4**	**$8.3**	**$0.0**
Fiscal 2007 Appropriations	593.3	229.6	0.0	0.0
Expenditures				
Fund Projects and Programs	-15.7			
Reimburse Transportation and Support ICC		-53.0		
Energy Subsidies for Low-income Residents		-12.5		
2006 Election Voting Machines		-22.0		
Substance Abuse Case Mgmt. Compact		-1.0		
Transfers to General Fund	0.0			
Estimated Interest	71.6			0.0
Estimated Balances 6/30/07	1,407.9	171.5	8.3	0.0
Fiscal 2008 Appropriations	162.8	153.0	0.0	0.0
Expenditures				
Reimburse Transportation and Support ICC		-53.0		
Defray Pension Enhancements		-51.5		
Reduce Unfunded OPEB Liability		-200.0		
Energy Subsidies for Low-income Residents		-19.0		
Substance Abuse Case Mgmt. Compact		-1.0		
Transfers to General Fund	-930.0			
Estimated Interest	33.9			
Estimated Balances 6/30/08	**$674.7**	**$0.0**	**$8.3**	**$0.0**
Balance in Excess of 5% GF Revenues	**$1.1**			

Note: Numbers may not sum to total due to rounding.

ICC: InterCounty Connector

OPEB: Other Post-employment Benefits