Maryland STATE TREASURER

Investing for Maryland's future.

TREASURER'S REPORT TO

LEGISLATIVE POLICY COMMITTEE

December 16, 2010

Nancy K. Kopp

State Treasurer

Section 5-104 of the State Government Article of the Annotated Code of Maryland provides that, *"The Treasurer shall address the Legislative Policy Committee of the General Assembly on a semi-annual basis and as necessary on issues of legislative importance, including the activities of the Board of Public Works, bond sales, and investment and procurement initiatives."* This Report is in fulfillment of that law and covers the period since the report of June 15, 2010. I invite and welcome further discussion with the Committee at your convenience.

The State Treasurer's activities and responsibilities are of particular concern to the Legislature. One of seven statewide Constitutional officers, and the only one elected by the General Assembly, the State Treasurer's duties are multifaceted and extend throughout State government and higher education. The Treasurer's duties include membership on the Board of Public Works and Board of Revenue Estimates and Chairmanship of the Capital Debt Affordability Committee. The Treasurer presently also serves as Chair of the Board of Trustees of the College Savings Plans of Maryland and the Board of Trustees of the State Retirement and Pension System. She is a member of the governing boards of the Teachers' and Employees' Supplemental Retirement Plans, the Maryland Health and Higher Education Facilities Authority, the Maryland Small Business Development Financing Authority and of the Maryland Agricultural Land Preservation Foundation. Several of these Boards work under the general oversight of legislative oversight committees which are in periodic receipt of reports and communications from the Office, as do the two legislative budget committees.

The State's fiscal picture seems to be improving, due to the strength and diversity of Maryland's economy, but the next two fiscal years seem to be shaping up to be the most challenging yet. While the State continues to face fiscal challenges, the Office continues to rely on the expertise of its small staff to assist agencies in improving their business processes. The Office continues to assist State agencies in many ways including expanding the use of innovative banking services such as remote deposit, negotiating reduced insurance premiums while enhancing coverage, and advising on procurements. We have also worked to improve our internal information technology programs to allow the Treasurer's staff to perform their functions more efficiently.

We continue to plan and conduct our bond sales effectively, while striving to maintain Maryland's coveted AAA bond rating. We monitor the market routinely to take advantage of savings as they become available in refunding our General Obligation Bonds or to issue new types of debt such as Build America Bonds and Qualified School Construction Bonds. Lastly, we continue to invest State funds carefully and conservatively to minimize risk to the Maryland taxpayers.

While we continue to be fiscally constrained, the Office is working hard and achieving real results. The items set forth below detail a number of these achievements and we are always available to provide greater information or answer questions regarding these and other issues.

BOARD OF PUBLIC WORKS

Between May 19, 2010 and November 3, 2010, the Board of Public Works (BPW) acted on 1,010 agenda items valued at $3,928,515,450.

Among the numerous contracts, wetlands licenses, land and easement acquisitions and lease modifications approved during the past six months, the following exemplify the scope of actions overseen by the Maryland Board of Public Works, the only constitutionally mandated organization of its type in the nation:

- $49.4 million purchase and lease of 1,062 Video Lottery Terminals (VLTs) at Penn National's Hollywood Casino in Perryville in Cecil County.
- Transfer of the *Pride of Baltimore II* from the Maryland Port Administration to Pride of Baltimore, Inc., a non-profit, for $1.
- Acquisition of a conservation easement on a 114-acre portion of Mt. Ararat Farms in Cecil County, overlooking the Susquehanna River.
- $15, 867,764 purchase of 438 additional VLTs for the Hollywood Casino in Perryville
- Receipt by the Maryland Environmental Trust for perpetual conservation easements of two parcels, 218.655 acres and 267.383 acres, in Queen Anne's County.
- Sale of General Obligation bonds totaling $485,220,000 at an average of less than 2% interest owed by the State
- Ground leases for the $1 billion State Center Development in mid-city Baltimore
- Modification of a lease for the Woodmont Chapter of the Izaak Walton League in Washington County
- $32.7 million purchase of 750 Video Lottery Terminals at Ocean Downs Racetrack in Berlin in Worcester County
- $667,831.68 per year lease of the new Charles County Court House in La Plata
- Naming of the Merkle Wildlife Sanctuary in Prince George's County for the late Frank Oslislo, longtime administrator at the Department of Natural Resources
- $267 million for modification of the prescription drug benefit plan for State employees to accommodate greater usage than originally projected
- Approval of development of the former site of the Chesapeake Bay Model on Kent Island in Queen Anne's County as the Matapeake Industrial Park—right to subdivide, termination of reverter clause on Phase I, extension of reverter clause on Phase II and reinvestment of the State's portion of the land revenue sale (20%).
- $72 million purchase of six new, multipurpose, medevac helicopters for use by the Maryland State Police.
- $320,000 for acquisition of .25 acres fronting Nanticoke River in Vienna in Dorchester County for a waterfront park and riverwalk.

The Treasurer's Office communicates frequently with legislators and their staffs about the Board agenda and items of specific interest to their districts. Feedback from legislators is essential to the Treasurer, as she represents the legislature on the Board of Public Works. The Treasurer's Office also receives comments and advice from the Department of Legislative Services to ensure that BPW agenda items are consistent with legislative policy.

INVESTMENT DIVISION

The Treasurer's conservative investment policy and STO practices have protected the portfolio through these difficult and unprecedented economic times. The par value of the General Fund investment portfolio for November 30, 2010 was $5,390,380,040 as compared to November 30, 2009 when it was $4,724,110,417. This is an increase of over $666 million dollars.

On November 30, 2010, the portfolio was earning an average of 1.889%, compared to 1.571% for the same date in 2009. The return reflects the impact of the Federal Open Market Committee maintaining the Fed Funds Target rate at .25% or less since December 16, 2008. The three month constant maturity Treasury bill averaged .15% since July 2010 as compared with .12% for the same time period in 2009. The low rate environment, combined with the highly conservative portfolio strategy, focused on liquidity to offset unpredictable and volatile cash flows has resulted in moderate but positive interest earned. The investment priorities remain as always – safety of principal, liquidity and, then, return.

The General Fund gross interest earnings received year-to-date for FY 2011 are $22,285,039 as compared with $71,668,881 received for the same time period in FY 2010. The almost $50 million decline in interest received is directly attributable to the continued lower interest rate environment.

The Committee may recall that during the last legislative session, as part of the Budget Financing and Reconciliation Act, the State reduced the number of individual agency accounts that receive an interest allocation from the total interest earned on the investment portfolio. The following chart depicts the historical pattern of interest earnings being directed away from General Funds and towards agency funds. Even with the change of Legislation last session, the General Fund is still only receiving 48% of the interest earned on State investments.

Total Interest Earned
% of Total Interest Earned Allocated to State Agencies

Fiscal Year	Net General Fund	Allocated to State Agencies	Total	% of Total Allocated to State Agencies
2000	121,951,720	103,173,287	225,125,007	46%
2001	136,981,074	144,249,899	281,230,973	51%
2002	82,641,807	66,399,769	149,041,576	45%
2003	37,205,637	42,240,523	79,446,160	53%
2004	25,037,345	29,053,449	54,090,794	54%
2005	52,886,074	54,538,463	107,424,537	51%
2006	149,613,238	109,222,108	258,835,346	42%
2007	150,798,001	205,589,917	356,387,918	58%
2008	155,170,184	207,179,098	362,349,282	57%
2009	102,768,740	142,619,087	245,387,827	58%
2010	44,190,425	87,921,654	132,112,079	67%
2011*	22,285,039	24,467,681	46,752,720	52%

*As of November 30, 2010

The securities lending program continues to provide additional revenue. The program has earned $94,579 so far in FY 2011. This compares with $75,431 for the same period in FY 2010. The ongoing Federal Reserve and Federal Treasury programs designed to add liquidity to the financial markets has reduced borrowers' need for the securities in the State's portfolio.

The Office continues to increase MBE participation in the investment of State funds. Nineteen MBE broker/dealers are on the Office's approved list for FY 2011 and they have handled investments of $590 million so far this year. This compares favorably to FY 2010, when the Office had 15 approved broker/dealers who handled over $250 million in investments by the end of October.

The Maryland Local Government Investment Pool (MLGIP) has maintained its AAAm rating through all of the turbulence in the money markets. The balance at November 30, 2010 was $3,393,752,092 compared with $3,055,974,521for the same date in 2009. This is an increase of over $338 million dollars due to the lack of safe short term investment alternatives for Investment Pool members at a comparable yield. The MLGIP is paying .19% as of November 30, 2010 as compared with .18% last year. The MLGIP has made minor adjustments to be in compliance with the new Money Market rules and regulations.

The Office continues to invest according to the officially adopted State Treasurer's Investment Policy, which sets out investment goals, priorities and constraints. The overriding goal is to assure sufficient liquidity to maintain uninterrupted funding of State government and legislated payments. As revenues have become less predictable and more volatile, the strategy has been adjusted to ensure liquidity. The Office continues to review and compare our cash management and investment policies and practices with those of peer AAA-rated States to ensure best practices are followed and implemented.

BANKING SERVICES DIVISION

The Banking Services Division remains focused on its mission to provide efficient, accurate, and timely banking services to all State agencies and external customers. Banking Service's processing controls and detailed transaction verifications have allowed us to identify bank and agency processing deficiencies, resulting in a more efficient and accurate delivery of banking data. Comprehensive and strict processing and accounting controls are continually reviewed and enhanced when appropriate to ensure the proper development and continuity of an accurate, documented, and auditable reconciliation of the State's cash accounts. The reconciliation is transparent, fully documented, and reconciled to the penny every day. Current highlights of activity include;

- Total cash receipts and disbursements each will exceed $120 billion for FY 2011.
- The State's bank accounts are reconciled daily to the State's general ledger within two days of receiving all necessary bank data.
- There are <u>no un-reconciled differences</u>. We reconcile the State's cash accounts <u>to the penny</u> every day.

Banking Services is in the final phase of the development of the new Treasurer's Bank Account Information System (TBAIS) to replace the current system maintained by the Comptroller's General Accounting Division. The new system will allow for a more efficient set up and approval process for agency bank accounts. This system will also enhance and further automate the management and control of the State's bank accounts, including the collateralization of State funds.

We continue our efforts to convert recurring vendor check payments to electronic payments, increasing efficiencies in the disbursement process. In addition, our Deposit Products team continues to work individually with agencies to ensure that the general ledger posting of the electronic receipt of funds, especially Federal grant receipts, is automated to the extent possible.

We are always actively working with agencies to develop and strengthen their internal processes and to promote efficient banking services. We are working with the Department of Natural Resources to implement the acceptance of credit cards for the purchase of sport licenses. We also continue to work with Judiciary on their ePayments initiative.

To further our work and communications with State agencies, Banking Services recently presented at the R*STARS Users Group meeting. The presentation was very effective and there was record attendance. As a result, we have been asked to present at the January Maryland State Internal Auditor Forum as well as to a Motor Vehicle Administration quarterly managers meeting.

Finally, as noted in past reports, we are continually working on standardizing our tracking, processing, and reconciliation of bank related transactions for the State's cash accounts in order to ease the ability to change banks if required by market conditions or the procurement process.

INSURANCE DIVISION

The Insurance Division is responsible for administering the State's Insurance Program which comprises both commercial and self-insurance. Commercial insurance policies are procured to cover catastrophic property and liability losses, and other obligations derived from State contracts, statutes and regulations. Among the several exposures covered by commercial policies are State maintained toll bridges and tunnels, rail operations, assorted professional liability exposures and student athlete accidents. The State also self-insures a significant portion of its exposures and maintains the State Insurance Trust Fund to pay claims and the costs associated with handling those claims. Self-insurance coverage includes State-owned real and personal property, vehicles, and liability claims covered under the Maryland Tort Claims Act.

The Insurance Division comprises four units: Underwriting, Loss Prevention, Claims and Tort Litigation. The Division's goal is to provide Statewide risk management through loss protection (Underwriting), loss control (Loss Prevention), and loss restoration (Claims).

Underwriting

The Insurance Division procures broker services for the purchase of commercial insurance to protect the State Insurance Trust Fund from catastrophic loss, to meet statutory or regulatory requirements, and for compliance with agency contractual agreements. Underwriting highlights for the past six months include the following:

The Maryland Port Administration crane coverage was renewed for FY 2011 on November 25, 2010. The crane values decreased due to the sale of cranes to Ports America Chesapeake in the P3 deal at Seagirt Marine Terminal. In addition to the decrease in values, **the rate was reduced 62%, saving the MPA $202,500 on the annual renewal.**

The Mass Transit Administration (MTA) had three renewals on July 1, 2010: excess liability, rail car coverage, and the bus/mobility vehicle fleet physical damage coverage. The excess liability coverage renewed with ridership up 4%, **and a premium savings of $86,200.** MTA's rail car coverage renewed with a 19% rate reduction. The limit of coverage was increased from $26 million to $50 million on the updated schedule of equipment, **saving the MTA $59,400 in premium**. The bus/mobility vehicle fleet coverage renewed with a limit increase from $15 million to $20 million. $1 million terrorism coverage was added, values were up 23% with new equipment including hybrid buses, and yet, the premium increase was held to $12,599.

The FY 2011 Athletic Participants coverage for 10 Maryland schools renewed August 1, 2010. Even with some losses, the Unit was able to reduce the premium for all but two schools. **The bottom line savings was $33,600**.

The FY 2011 airport liability coverage for the Maryland Aviation Administration renewed August 15, 2010. Our carrier was able to **reduce the premium by $187,000**, **which represents a 23% savings**. The State is also in a program that may return premium after the policy expires, if the losses in the program remain low.

The FY 2011 policy for Maryland Transportation Authority's toll bridges and tunnels liability renewed October 17, 2010. The premium was up slightly when the lead carrier out of seven, took a small increase. The coverage was renewed with a premium increase of $23,700 but coverage improved because the Unit increased terrorism coverage from $7 million to $32 million.

The Underwriting Unit frequently addresses agencies' questions about commercial insurance coverage and worked with five agencies on special projects in the first half of FY 2011. For example, the Director of the Insurance Division and the Underwriting Manager consulted with the State Lottery Agency about insurance coverage related to the opening of the first two casinos in Maryland; with the Department of Natural Resources regarding insurance issues for the Curatorship Program; Coppin State University regarding the insurance needs for the 200 plus town homes they are buying to build a future Science and Technology Center; the Department of General Services regarding the State Center Project in Baltimore, Maryland; and the University of Maryland Center for Environmental Science regarding insurance needs for a new project involving ballast water testing in the Chesapeake Bay.

Loss Prevention

The aim of loss prevention is to help State agencies implement specific action plans and safety practices to mitigate their most frequent or severe sources of preventable losses. To do this, on an annual basis the Loss Prevention Manager conducts a review of numerous State agencies' claims and loss histories to identify problem areas and to help those with high severity claims and/or frequency take corrective measures. After the Manager identifies agencies with above-average claims frequency and severity, the Manager meets with agency risk managers to discuss the findings and recommendations.

The Loss Prevention Manager also identifies, coordinates and oversees loss control service hours provided by our insurance brokers to the State agencies. This fiscal year's outreach activities have resulted in a dramatic increase in requests for loss control services. Thus far, State agencies and universities have requested services for infrared thermographic imaging, aerial infrared testing, and property inspections. Due to their popularity, the Loss Prevention Manager has prioritized the receipt of risk control services on the basis of the type and the severity of the exposure.

In August 2010, loss control services were offered and coordinated to assist the Maryland State Police Aviation Command (MSPAC) with initial and annual recurrent training on Fatigue Management Training to all flight crewmembers. Training will begin in the coming weeks. Thus far, all services provided to MSPAC, such as guidance to obtain a Letter of Compliance, and the Comprehensive Operational Gap Analysis and Safety Assessment, were offered to help the Aviation Command Unit address some of the safety recommendations made by the National Transportation Safety Board following the tragic crash on September 27, 2008, involving Trooper II.

The infrared inspections, noted above, provide valuable information on the condition of equipment and roofing systems in State agency facilities. Thermographic imaging identifies loose connections that create heat that can be imaged to show the exact location of a defect. An infrared inspection of an electrical distribution system is designed to identify potential equipment failures before they happen so that appropriate action can be taken before costly repairs and downtime are incurred.

The University of Maryland Baltimore County, Maryland Stadium Authority (Oriole Stadium Park), Maryland Food Center Authority (Wholesale Produce Market), and Department of Health and Mental Hygiene (Eastern Shore and Springfield Hospital), and Department of Labor, Licensing, and Regulation (Headquarters) have been tested.

The purpose of aerial infrared testing is to identify the location of moisture penetration of roofing systems before there are visible signs, structural damage or business interruption. With the results of this analysis, State agencies and universities can significantly extend the life of roofing structures while reducing maintenance expenditures and potential property-related claims. The Department of General Services (Annapolis Complex) and the University of Maryland College Park were recently selected to participate in the aerial testing program.

Claims

The Insurance Division's Claims Unit investigates and resolves liability claims arising from services provided by the State under the Maryland Tort Claims Act, Md State Government Code Ann. §12-101 *et seq.* The unit also handles claims for damage to State-owned property arising from sudden and accidental perils such as collision and comprehensive loss to autos, and from a number of other perils such as fire, hail, lightning, wind, etc. which causes damage to State structures, equipment, and contents.

One measure of the Claims Unit's productivity is the number of claims resolved compared to the number of claims filed within a specified period of time. In each fiscal year since FY 2005, the Claims Unit has met its productivity goal by bringing to closure at least one claim for every claim filed with the Treasurer's Office. The unit remains on track in FY 2011. Between July 1, 2010 and November 8, 2010, the unit received 1,413 claims and closed 1,718 claims, exceeding the goal by approximately 20%.

One reason for the Division's success in meeting its goals is because management continually reviews its organization, processes, and procedures. The Claims Unit must meet the public's demand for fair and timely investigations of claims filed under the Maryland Tort Claims Act and meet the State agencies' demand for prompt and accurate processing of State-owned property claims.

Claims Adjuster Training

The Insurance Division's management is committed to providing relevant, timely, and cost-effective continuing education opportunities for its personnel. To this end, the Insurance Division has partnered with its sister State agency, Maryland Auto Insurance Fund (MAIF), to deliver "just-in-time", low cost auto claims training.

In August, the adjusters attended a training session on auto damage nomenclature. The class was taught by MAIF's Material Damage Manager, who covered several topics including understanding major automobile systems and component terms; evaluating auto damage appraisals; and detecting fraudulent repair shop practices. MAIF is planning to conduct a class on how to evaluate low-velocity impact injury claims in early 2011.

In order to protect consumers from unknowingly purchasing vehicles that have been branded as salvage, the Motor Vehicle Administration (MVA) as prescribed in the Transportation Article §13-506.1, now requires insurance companies to promptly notify the MVA if the company settles a claim on a vehicle that is salvage and the owner retains possession of the vehicle. Recently, the Office of the Attorney General (OAG) determined that the term "insurance company" applies to the State of Maryland as a self-insurer. Following the advice of the OAG, the Insurance Division developed a procedure to comply with the statutory requirements.

Medicare Reporting

The State of Maryland is required to report to the Centers for Medicare and Medicaid Services (CMS) certain information on Medicare-eligible claimants who receive injury settlements that are paid from the State Insurance Trust Fund. The legislation, which was enacted by the federal government, has provisions that permit CMS to assess fines if the State does not comply with the data reporting requirements.

Insurance Services Office, Inc. (ISO) is a provider of Medicare Secondary Payer Reporting services for insurers and self-insurers. ISO helps the Division determine which claimants are Medicare-eligible and reports the appropriate claims to CMS on behalf of the Treasurer's Office. The Division had reported claims to ISO prior to the enactment of the federal legislation for the purposes of detecting fraudulent injury claims.

Tort Litigation

The Litigation Manager works closely with the Office of the Attorney General to proactively resolve these matters by investigating and evaluating cases, providing settlement authority or when necessary, by briefing the Insurance Review Committee on high dollar value settlements, and by attending settlement conferences and other court mandated activities. The Litigation Manager also works closely with the claims adjusters to provide feedback on investigations conducted by the adjuster. The Litigation Manager may also brief an adjuster on the status of certain litigation claims of interest.

In FY 2011, the Litigation Manager began tracking the reason for or actual method of disposition of all cases closed on or after July 1, 2010. The disposition reason or method of each case is noted in the following table:

Disposition	Reason or Method	Count
Dismissal	Motions granted	2
	Notice of claim not provided	1
	State not served	1
	Non – State	2
	Voluntary w/o prejudice	2
	Voluntary w/prejudice	1
Verdict	Adverse	1
	Defense	3
Settlement	Pre trial settlement	1
	Pre trial hearing	2
	Settlement conference	6
TOTAL CASES CLOSED ON OR AFTER July 1, 2010		**22**

INFORMATION TECHNOLOGY DIVISION

The Information Technology Division (IT) provides a platform of integrated systems to support the State Treasurer's Office's (STO) operations. Over the past six months, the IT Division worked with the Office's Divisions and our State agency clients to support many changes and upgrades.

Our most recent project is the development of the Treasurer's Bank Account Information System (TBAIS). This system being developed by the Banking and IT Divisions will replace the current system hosted by the Comptroller's General Accounting Division (GAD). The new system will allow agencies to request authorization to open or close bank accounts via a web based form. The TBAIS application, hosted on our IBM i5 System, will track and electronically route the request to Banking and GAD for authorization or denial. Authorized accounts will then be automatically added to the account database. Programming is nearing completion and is now being tested for installation prior to yearend.

The IT Division made numerous enhancements to the IBM i5 System client screens and reporting. We worked with the Administration Division and provided additional reporting for the Recovery/Reimbursement process, A/R Detail Aging report and expanded the controls that ensure A/R amounts match Claim Subrogation balances. IT performed maintenance on the Insurance Division's Claim Management System in preparation for the FY 2010 Actuary Report. IT is also enhancing Banking's wire reconciliation and R*STARS postings by logically matching incoming deposit file wire transactions against our validation table and automatically encoding the transaction with the required accounting information.

Our IBM i5 System had a few changes as well. We are currently testing the addition of an outbound only email function on our IBM i5 System. This new feature will be used to send out notifications and reports to STO and other State agencies. We also completed: the setup of alternative check printers to be used for short term contingency, added DFU screen usage to our security reporting and added our first Connect: Direct data transmission to a MS Windows based server. This change was necessary so that STO could retrieve check and direct deposit files from State Retirement's new system.

The IT Division continued to process disbursements for GAD, Child Support, Cares, Retirement and Central Payroll working with Central Payroll to grant them access to the Banking Check Research system to provide them the current status of issued payroll checks.

DEBT MANAGEMENT DIVISION

Ratings

Maryland is one of eight states with AAA ratings from all three rating agencies. The states are Maryland, Delaware, Virginia, North Carolina, Georgia, Missouri, Iowa and Utah.

The State Treasurer's Office maintains frequent contact with the rating agencies and schedules conference calls with each of them prior to every bond sale as we did on June 29, 2010 just prior to the sale of 2010 Second Series General Obligation Bonds. Participating in the most recent conference call were the Treasurer, Comptroller, Secretary of Budget and Management, Director of the Bureau of Revenue Estimates and the Director of Policy Analysis for the General Assembly and staff.

The Rating Agencies are generally uniform in their assessment of Maryland's credit. They cite Maryland's history of prudent, moderate debt and budget management, its protected Rainy Day Fund and other reserves, its Capital Debt Affordability and Spending Affordability processes, its 15-year General Obligation bond terms and other strong evidence of prudent stewardship. However, they also note the serious financial challenges posed or exacerbated by the recession, including State revenue shortfalls, outstanding liabilities such as the public pension and retiree benefit obligation, and increased demand for public services. They are particularly concerned about how states (including Maryland) will manage without stimulus funds and about Maryland's significant structural budget deficit.

Questions arose during the 2010 Legislative Session on the prudence of using Rainy Day funds to bridge the budget gap. There have been ratings downgrades of governments which have used reserves without a plan to replenish the account and without a plan to resolve future structural deficits. It appears that until the State can project revenue growth, it is wise to maintain the reserve balance at 5% of revenues. Until then, the reserve balance is a hedge against any future revenue shortfalls during this recession. Again, Standard and Poor's clearly states, "Maryland has made a steady commitment to funding reserves, which we believe enhances its flexibility in the current economic environment."

The next conference call with the rating agencies is expected in February 2011, prior to the sale of the 2011 First Series General Obligation Bonds. In the meantime, the Office provides monthly revenue performance and Reports from the Board of Revenue Estimates to the rating agencies.

Closed Financings - General Obligation Bonds

Since our last report, there has been one General Obligation Bond Sale. The 2010 Second Series totaled $485,175,000, closed on August 10, 2010 and had four series:

Series A - $143.3 million in tax-exempt bonds sold in a negotiated sale with first priority to Maryland citizens

Series B - $221.7 million in tax-exempt bonds sold in a competitive sale primarily to institutions

Series C - $75.0 million in taxable Build America Bonds (BABs) with a direct 35% interest subsidy from the US Treasury

Series D - $45.2 million in taxable Qualified School Construction Bonds (QSCBs) with a direct 100% interest subsidy from the US Treasury.

Compared to traditional tax-exempt bonds, the BABs and the QSCBs generated $24.5 million in present value interest savings for the State.

Closed Financing - Leases

The capital lease-financing program allows State agencies to acquire equipment and pay for those items over a three, five, or ten year time frame. Between May 16, 2010 and November 15, 2010, $1,683,479, in capital equipment (primarily IT equipment) was leased by State agencies through the State Treasurer's Office.

The Treasurer's Office also finances Energy Performance leases in cooperation with the Department of General Services (DGS), providing funding for energy conservation at State facilities. The program finances significant up-front investments in conservation projects and the lease is paid for using the savings in operating costs. One Energy lease in the amount of $13,920,000 was financed between May 16, 2010 and November 15, 2010.

2011 Financing Plans

Video Lottery Terminals (VLTs)

The State expects to finance the purchase of approximately $330.8 million of Video Lottery Terminals ("VLTs") at five locations in Maryland.

PROJECTED VLT Financing	**as of 10/20/10**
Penn National	$29,000,000
Ocean Downs	$12,500,000
Arundel	$68,000,000
Arundel	$66,300,000
Baltimore City	$110,000,000
Rocky Gap	$45,000,000
	$ 330,800,000

The State will pay for VLTs totaling $41.5 million in early CY 2011 for two of the locations (Penn National in Cecil County and Ocean Downs in Worcester County). Because of the private activity associated with VLTs, any method of financing will be taxable instead of tax-exempt.

Under the authority conferred by Section 8-403 of the State Finance and Procurement Article, with the approval of the Board of Public Works and the statutorily-required prior notification to the Legislative Policy Committee, Counsel to the Treasurer has advised that the Treasurer may authorize a lease-purchase agreement for the acquisition of video lottery terminals to be structured and sold as Certificates of Participation (COPs). COPs are not themselves obligations of the State they are evidence of the investors' interest in the State's payment obligations in an underlying lease-purchase agreement.

COPs enjoy the liquidity of marketable securities, similar to municipal bonds, and for practical purposes COPs function like municipal bonds. But COPs do <u>not</u> evidence full faith and credit pledges of the State; the State's obligation to make lease payments is subject to annual appropriation.

The State Treasurer has established three major goals for this transaction. They are: financing at the lowest cost of capital, participation by minority firms, and a transparent process.

To compare whether the lease financing or COPs would achieve the lowest cost of capital, the STO requested an analysis by the State's financial advisor. Public Financial Management (PFM) concluded that the sale of COPs would deliver the best financial results for the State. To achieve the goal of minority participation, the Treasurer has appointed two minority firms to serve as underwriters. Both these firms were part of the pool of underwriters that were competitively selected in 2008. Finally, to achieve transparency, the STO invites the legislature and other interested person to observe the COPs pricing in early January 2011. After the sale the financial advisor will compare Maryland's results with similarly rated sales.

General Obligation Bonds, Series 2011 First

At this time, the STO is beginning to structure the 2011 First Series issue. Tentatively, the sizing will be approximately $485 million including $6.5 million of taxable Qualified Energy Conservation Bonds (QECBs) which have a 70% direct interest subsidy from the US Treasury. At this time, because the US Congress has not extended BABs beyond December 31, 2010, the balance of the 2011 First Series will be tax-exempt. The STO is again planning a retail component with first priority to Maryland citizens in this sale.

The STO encourages legislators and all interested persons to attend the competitive sales and/or the pricing calls for the negotiated sales. When the dates are set, the Office will notify the Legislature.

Status of the Annuity Bond Fund

Debt service on General Obligation Bonds is paid from the Annuity Bond Fund (ABF) and the primary source of revenue for this fund is real property tax receipts. In fiscal years 2011 and 2012, it is projected that there are sufficient property tax receipts, surplus transfers from prior years and bond premium to cover debt service without any General Fund subsidies. However, if the real property tax rate continues at the current level of 11.2¢ per $100 of assessed valuation and future debt is issued at the rates projected in the 2010 CDAC Report, subsidies of General Funds may be necessary to support the debt service on General Obligation bonds beginning as early as 2013.

CDAC Affordability Criteria

At the September 2010 meeting, the Capital Debt Affordability Committee (CDAC) recommended a $925 million limit for new General Obligation authorizations by the 2011 General Assembly to support the 2012 capital program. The Committee's projections for future authorizations assume generally level authorizations through 2016 of between $925 million and $955 million. In 2017 the projected authorization is $1,200 million and it increases by approximately 3% (assumed rate of inflation) through 2020. With these authorization levels, the debt affordability ratios remain within the CDAC benchmarks of 4% debt outstanding to personal income and 8% debt service to revenues.

The motion to adopt this level specifically recognized that authorization levels proposed in the Governor's 2012 capital budget could be adjusted to reflect up-to-date economic and fiscal information and the Board of Revenue Estimate's December revenue estimates. Accordingly, the Capital Debt Affordability Committee will review its authorization in December 2010 and make any necessary modifications to its recommendation.

As noted in the opening section of this Report, present revenue and market conditions continue to impact the operations and achievements of the State Treasurer's Office in many ways. The Treasurer appreciates the opportunity to provide this report to the Legislative Policy Committee on a regular schedule. A copy of this report is also available on the State Treasurer's website: www.treasurer.state.md.us. If the Committee or its members would care to pursue further these or other STO developments, or any other aspects of the Treasurer's activities, please call the Treasurer at (410) 260-7160 or Chief Deputy Treasurer Bernadette T. Benik at (410) 260-7390.