



**TREASURER'S REPORT TO
LEGISLATIVE POLICY COMMITTEE**

December 16, 2014

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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 1, 2014. 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 committees which are in periodic receipt of reports and communications from the Office, as do the two legislative budget committees.

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, such as by refunding our General Obligation Bonds or issuing new types of debt such as Qualified Zone Academy Bonds. And as you know, we continue to invest State funds prudently and conservatively to minimize risk to the Maryland taxpayers.

The items set forth below detail a number of our recent achievements and we are always available to provide greater information or answer questions regarding these and other issues.

BOARD OF PUBLIC WORKS

Between June 1, 2014 and November 30, 2014, the Board of Public Works (BPW) met ten times to consider State procurements, expenditures of capital appropriations, the acquisition, use and transfer of State assets, issuances of licenses to dredge and fill wetlands, and the acquisition of land and easements in support of Program Open Space, the Conservation Reserve Enhancement Program, the Rural Legacy Program and the Agricultural Land Preservation Program.

During this timeframe, in addition to the State General Obligation Bond Authorizations, including Qualified Zone Academy Bond authorizations, and the Capital-Lease financings discussed in more detail in the Debt Management Section of this Report, the following items, worthy of note, were considered by the Board of Public Works:

Procurement

- Approved the award of a contract to provide consulting services to undertake availability and utilization studies for minority and women-owned businesses in the State as a part of the re-assessment of the need for the continuation of the State's MBE Program. The timeframe to be studied is 2010 – 2014. The study will take 18 months to complete and is due to the Maryland General Assembly by September 2016. (09/03/14)
- Approved submitting to the AELR Committee and publishing for comment in the *Maryland Register* (10/29/14):
 - New regulations and amendments to existing COMAR provisions to implement legislation that requires regulatory action and enacted during the 2014 Legislative Session. The regulations will:
 - Expand the bases for debarment to include violations of the Internal Revenue Code and violations of the State's Living Wage and Prevailing Wage laws (Chapter 189, Laws of 2014);
 - Update the membership and requirements of the Green Purchasing Committee (Chapter 604, Laws of 2014);
 - Repeal regulations relating to unsolicited proposals as a result of the sunset of the unsolicited proposal law; and
 - Repeal regulations related to individual sureties as a result of the sunset of the individual surety laws; and
 - Regulations that clarify veteran-owned small business requirements by providing that a veteran-owned small business prime contractor may use its own workforce to meet a VSBE goal.

- Approved regulations for final adoption that:
 - Require agencies to designate a Small Business Reserve Program liaison; (10/29/14) and
 - Require all school construction projects that include replacing or upgrading the electrical system to be designed and constructed to be fully powered in the event of an emergency in order to increase the number of schools that may be used for sheltering purposes during an emergency. (10/29/14)
- Updated the list of companies engaged in investment activities in Iran. Inclusion of companies on the List renders the companies ineligible to bid on, submit a proposal for, or enter into or renew a contract with a public body in Maryland for goods or services. (07/23/14)

Personnel – FY 2014

- “Rule of 100”: The FY 2014 Budget enables the Board of Public Works to authorize the creation of up to 100 positions within the Executive Branch. During June 2014, the BPW authorized the creation of 35 career service positions within the Mass Transit Administration. The positions will provide MTA with additional non-sworn security guards and fare evasion prevention staff.
- In FY 2014, the BPW authorized the creation of 68.7 positions within the “Rule of 100” and 10 positions outside of the “Rule of 100”.

Personnel – FY 2015

- “Rule of 100”: The FY 2015 Budget enables the BPW to authorize the creation of up to 100 positions within the Executive Branch. Between July 1, 2014 and November 30, 2014, the BPW authorized the creation of 53.1 positions:
 - 0.9 positions at the Maryland Institute for Emergency Medical Services System (MIEMSS) by increasing a 0.50 full-time equivalent (FTE) position to a 1.00 FTE position to maintain the Maryland Trauma Registry and a 0.60 FTE position to a 1.00 FTE position to provide a full-time Assistant Attorney General to conduct a major revision of the EMS Education Program regulations, to develop new pediatric transport regulations, and to work with a task force looking at due process issues in the jurisdictional medical review process (09/03/14);
 - 1.0 special-funded position at the Maryland Community Health Resources Commission (CHRC) to provide budget, fiscal and procurement support and grant oversight for the CHRC (10/01/14);

- 0.2 positions at the State Board of Elections by increasing a 0.6 FTE position to a 0.8 FTE position for an Office Secretary (10/01/14);
- 45 FTE positions at the Department of Human Resources to perform additional work associated with the implementation of the new Health Benefit Exchange System (10/15/14);
- 4.0 special-funded positions (videographer, producer, two associate producers) at Maryland Public Television to support MPT's Maryland Farm and Harvest series (11/12/14); and
- 2.0 general-funded positions within the State Treasurer's Office to provide, on behalf of the Board of Public Works, fiscal oversight, contract development and ongoing workers' compensation contract management of the State's contract with the Injured Workers' Insurance Fund. The positions will be filled if a deficiency request for funding is included in the FY 2015 final appropriation for the State Treasurer's Office. (11/12/14)

FY 2015 State Operating Budget

- Approved reductions in the FY 2015 State budget totaling \$77,145,041 representing a \$75,945,041 reduction in General Funds, a \$1.2 million reduction in Special Funds, and a reduction of sixty-one positions. (07/02/14)

Salaries of Elected Officials

- Approved the recommendation of the Chief Judge of the Court of Appeals and the State Court Administrator to increase the salaries of the Clerks of the twenty-four Circuit Courts to become effective at the beginning of the next term of office for the duration of the new term. (09/03/14)
- Approved the recommendation of the Comptroller of Maryland to increase the salaries of the Registers of Wills of the State's twenty-four jurisdictions to become effective at the beginning of the next term of office for the duration of the new term. (09/17/14)

Lottery & Gaming

- Approved the award of contracts to four additional fund managers to provide capital and loans to small, minority and women-owned businesses across the State as a part of the Small, Minority and Women-Owned Business grant program funded by Video Lottery Terminal (VLT) proceeds and allocating \$5.1 million of VLT revenues to these fund managers. (06/18/14)

- Approved additional grant funding of \$4 million for two incumbent fund managers to provide investment capital and loans to small, minority and women-owned businesses across the State with MD VLT proceeds. (06/18/14)
- Approved the five-year renewal of the State's multiple award master contracts with nine VLT manufacturers to lease or purchase VLTs for use at the Ocean Downs and Rocky Gap VLT facilities. (10/15/14)

Public School Construction & K-12 Education

- Approved the award of a contract to study the adequacy of funding for education in the State which is a follow-up study required by the 2002 Bridge to Excellence in Public Schools Act (Thornton). (06/18/14)
- Approved the award of a contract to provide a complete assessment system to the Maryland State Department of Education for the Partnership for Assessment of Readiness for College and Career (PARCC) assessments of the Common Core curriculum in English/Language Arts/Literacy and Mathematics for students in grades 3-8 and Algebra and English for high school students. (09/03/14)
- Approved the request of the Maryland Stadium Authority to award the first design and engineering services contracts for the replacement and renovation of two schools in Baltimore City (Fort Worthington and Frederick Elementary Schools) pursuant to the Baltimore City Public Schools Construction and Revitalization Act of 2013 (Chapter 647, Laws of 2013) (09/17/14)
- Approved the transfer of the Laurence G. Paquin Building #457 School and the CORPS Building from the Baltimore City Board of School Commissioners to the Baltimore City Government as a part of the school closure commitment contained in the four-party Memorandum of Understanding entered into pursuant to the Baltimore City Public Schools Construction and Revitalization Act of 2013. (Chapter 647, Laws of 2013) (10/01/14)

University System of Maryland

- Approved the sale of 3.1 +/- acres of real property located on U.S. Route 1 in College Park to an affiliate of the University of Maryland College Park Foundation for private development as a University hotel and conference center. (07/02/14)
- Approved the University of Baltimore accepting the assignment of a purchase and sale agreement that will enable UB to acquire a 4.259-acre site in Baltimore City for eventual exchange with the United States Postal Service. The exchange will allow UB to acquire a 2.5-acre parcel of land on Oliver Street in Baltimore City. (06/18/14)

- Ratified an emergency contract the University of Maryland College Park awarded to provide immediate protection against identity theft to over 300,000 individuals whose personal information was accessed via cyber intrusion in February 2014. (07/23/14)
- Approved the award of a contract to upgrade the public safety wireless communications system at Towson University with a 700 MHz platform to interface with the statewide Public Safety Wireless Communications System for First Responders. (07/23/14)
- Approved the award of a contract to provide construction services to build a new softball field complex at the site of the old softball field at Towson University. (08/13/14)
- Approved Towson University selling the former president's residence on Greenway Avenue in Baltimore City for \$1,050,000 after declaring the property as surplus on May 28, 2014. (08/13/14)

Public Safety

- Approved a modification of an existing architectural and engineering services contract for the Baltimore City Youth Detention Facility to provide for additional design services for a feasibility study, optional concept designs and cost analysis between:
 - A partial demolition and major restoration of the existing Baltimore Pre-Release Unit (BPRU), renovation of a portion of the adjacent Occupational Skills Training Center located in the Baltimore Correctional Complex, plus a new addition to meet the program needs of a 60-bed Youth Detention Center facility for youth charged as adults; and
 - The complete demolition of the existing BPRU building and provision of a new building to meet the program needs of a 60-bed Youth Detention Center facility for youth charged as adults. (07/23/14)
- Approved the issuance of a notice to proceed to implement Region 4, Western Maryland for the statewide Public Safety Wireless Communications System for First Responders. (07/02/14)
- Approved a modification of the State's AW139 medevac helicopter contract with Agusta Westland to provide for, among other things,:
 - The purchase and installation of a flight training device that replicates the operations and functionality of the AW139;
 - The removal of Night Vision Goggle Training from the requirements of the contract;
 - The acquisition and installation of mast vibration absorbers for each AW139 aircraft;

- Additional pilot training time; and
- An extension of the contract until 2016 to allow the Legislature time to decide whether to appropriate funds to purchase the 11th AW139 helicopter. (09/03/14)

State Services and Facilities

- Approved the awards of 10-year contracts to provide health benefits for eligible participants of the State's Employee and Retiree Health and Welfare Benefits Program beginning with the plan year effective January 1, 2015. With these contracts, health plan participants will be required to complete certain wellness program requirements to be eligible for enhanced benefits while members who chose not to complete the healthy activity requirements will be subject to an annual premium surcharge beginning in Plan Year 2016. (08/13/14)
- Approved the awards of 5-year contracts to provide health benefits for the State Law Enforcement Officers Labor Alliance. The Contractors will begin offering their plans as of January 1, 2015. (08/13/14)
- Approved the awards of 5-year contracts to provide Dental Plan Administration and Insurance Services for State of Maryland employees, retirees, and eligible dependents as part of the State of Maryland Employee and Retiree Health and Welfare Benefits Program. (08/13/14)
- Approved the award of a contract to ValueOptions, Inc. to provide an integrated behavioral health Administrative Service Organization (ASO) model managing substance abuse services and mental health services for Maryland's Public Behavioral Health System. (09/03/14)
- Approved the Maryland Archives' 15-year lease of warehouse space recently purchased by MEDCO to accommodate the Archives' needs for storage of the State's records of permanent value and fine arts collection. (09/17/14)
- Approved the State's purchase of the historic Brice House in Annapolis using \$2,500,000 of Program Open Space funding and the subsequent addition of this property to the State's master lease of historic properties managed by Historic Annapolis, Inc. (10/29/14)

Land Conservation Programs

- Approved the donation to the State of real property known as Reedy Island, consisting of 6.61 +/- acres located on the Bayside of Ocean City. The undeveloped land is important habitat for nesting bird species and will be managed by the Department of Natural Resources (DNR) as part of Sinepuxent Bay Wildlife Management Area. (08/13/14)
- Approved DNR accepting a real property donation of 42.58 +/- acres in Frederick County from the Civil War Trust. The property was the site of Civil War troop movements leading

up to the skirmish of Fox's Gap, a key engagement of the Battle of South Mountain. (08/13/14)

- Approved the use of \$2,781,300 of Program Open Space (POS) funding to acquire a 254.75 +/- acre farm in Kent County to help maintain the ecological integrity of the adjoining Big Mill Pond Fish Management Area, safeguard forest and wildlife habitat, and protect the water quality of the headwaters of the Chester River. Conservation of this property will provide the public with enhanced recreational opportunities related to the Fish Management Area. (11/12/14)
- Approved the use of \$1,660,000 of POS funding to acquire 212 +/- acres in Lexington Park, St. Mary's County, with beach access to the Chesapeake Bay. Purchase of this property, with approximately 3400 linear feet of water frontage, will allow for passive recreational and waterfront activities. The United States Navy is contributing \$2,340,000 towards the purchase of this property. (11/12/14)
- Approved FY 2015 funding for 18 Rural Legacy grants, totaling \$16,034,000, that will protect approximately 4,500 acres. (09/03/14)

Wetlands Licenses

- Approved an application for a wetlands license for the Maryland Broadband project. The license will allow the emplacement of a 7.4 mile broadband fiber optic cable from Cambridge in Dorchester County crossing the Chesapeake Bay and terminating in Calvert and St. Mary's Counties. (06/18/14)
- Approved the Dominion Cove Point LNG application for a wetlands license to construct a temporary pier and mooring piles for offloading industrial equipment from barges. The equipment will be used in the construction of an LNG exporting facility at Dominion's Cove Point LNG importing plant. (07/23/14)

Transportation

- BWI Marshall Airport:
 - Approved an expedited procurement request from the MD Aviation Administration for the construction of the D/E Connector and Security Checkpoint project at BWI in order to accommodate existing and expected airline services, including Southwest Airlines' expansion into international markets. This project entails:
 - Widening and renovation of the "throat" portion of Concourse D in order to comply with current safety building code requirements;
 - Construction of a new D/E Connector with a separate "sterile corridor" to the International Arrival areas in Concourse E;

- Reconfiguration of two existing domestic aircraft gates into two gates that will be capable of servicing either international or domestic flights; and
 - The construction of a new passenger security screening checkpoint. (07/23/14)
- Approved the award of a contract for the demolition and removal of the former Sheraton Four Points Hotel complex at BWI Marshall Airport. (10/01/14)
- Approved the five-year renewal of the State's Vehicle Emissions Inspection Program (VEIP) contract to manage and operate the 18 centralized vehicle emissions inspection stations located in 13 counties and Baltimore City. (09/03/14)
- Approved a 10-year Joint Use Agreement with the U.S. Air National Guard for use of the runways, taxiways and other common-use facilities at Martin State Airport. (09/17/14)

TREASURY MANAGEMENT DIVISION

The Treasurer created the Treasury Management Division during fiscal 2013 through a merger of the Banking and Investment Divisions. The goal is better service for all State agencies and better use of the available human resources in the State Treasurer's Office. The merger has already allowed many advances in computerization and streamlining of processes. The objective is to become a paperless work environment with all records and business processes in electronic format. The Division is currently scanning all required records from July 1, 2012 forward.

Banking Services Department

The primary mission of the Banking Services Department (BSD) is to manage and control relationships with vendors providing financial services for the State of Maryland, to anticipate agency banking requirements, and respond timely to agency requests.

The Department is directly responsible for managing the banking needs for all agencies of the State. BSD continues to oversee enhancements added to lockbox processing and improved reconciliation processes throughout the State. Total business process improvement at the agencies continues.

The Department procures financial products and services statewide. Six months ago, BSD conducted a procurement on behalf of The College Savings Plans of Maryland (CSPM) to provide services for the accounts and assets under the control of the Board, including depository, disbursements, lockbox and custodial services. The most recent six months required oversight of the implementation process for the procured services for CSPM. The Department continued the implementation process for the new Agency Depository Contracts for statewide banking depository services. Almost 500 agency bank accounts are in various stages of being moved to the newly designated depositories. Additional RFPs are in process, two for WIC and one for an Investment Advisor and Bidding Agent.

BSD continues to ensure the accurate and timely recordation of State funds and the reconciliation of the State's bank accounts to the State's R*STARS accounting system. The Department must account for the receipt of all warranted deposits and the disbursement of all warranted payments. To meet these responsibilities, a comprehensive daily cash reconciliation is performed which allows BSD to proactively resolve agency banking issues. Even as the volume of transactions has increased, the processes and controls developed by BSD continue to result in a timely, accurate, and well documented reconciliation of the State's cash accounts. For fiscal year 2014, total cash receipts and disbursements exceeded \$124 billion. As of October 30th total cash receipts and disbursements exceeded \$30 billion for the current fiscal year. The State's General Fund bank accounts continued to be reconciled to the penny on a daily basis to the State's general ledger.

In addition to the reconciliation duties, the Department performs daily operational functions that are critical to the movement of funds into and out of the State's bank accounts and to the recordation of these transactions in R*STARS. These include:

- Processing the drawdown of funds from federal programs and grants

- Initiating Fed wire payments
- Managing foreign currency transactions
- Processing check stop payments, cancellations and reissues
- Initiating replacement checks for failed ACH payments
- Recovering funds for fraudulent check presentments
- Providing transaction research assistance to State agencies
- Managing the Unpresented and Undeliverable Check Funds
- Recordation in R*STARS of all bank adjustments
- Maintenance of tables to allow for accurate posting of electronic receipts

During the past six months, BSD continues to work with several agencies in streamlining their receivables collection processes through implementation of the Bank of America Payment Collection Gateway service. The Payment Collection Gateway continues to be upgraded and enhanced for greater efficiency and payment processing. Many of the agencies will be receiving new and better equipment for more secure and faster processing.

BSD continued to work with the Department of Information Technology and NIC USA, on the implementation of self-funded eGovernment applications using a centralized web portal.

The Department and the Office's Information Technology Division implemented a Controlled Disbursement Account at the State's Disbursement Bank (M&T Bank). This process has already improved control over fraudulent checks presented to the disbursement account. There has been a marked increase in fraudulent check presentments nationwide and the State's accounts have not been spared.

Another responsibility of the Department is to ensure protection of all State funds on deposit with financial institutions through monitoring of bank account and collateral balances. Utilizing the Treasurer's Bank Account Information System (TBAIS), BSD monitors over 1,800 agency bank accounts at 23 financial institutions. Total posted collateral as of October 31, 2014 was \$658+ million. The annual Bank Account Survey, a verification tool used to ensure all accounts are collateralized appropriately and monitored monthly has been completed. The results of the survey were updated in TBAIS to ensure collection of all interest owed to the General Fund.

The BSD continues to serve as the State's authority for the development, control and maintenance of statewide policies and procedures for banking products and services. We continually strive to stay at the forefront of changes in banking products and services offered in the financial industry. The Department will continue to explore new financial products and improved data delivery methods that will increase its capabilities to provide efficient, cost-saving, banking and financial services to Maryland State agencies.

Investment Department

The Treasurer's conservative investment policy and practices have protected the investment portfolio through these continued unprecedented economic times. It is a true accomplishment in this environment to report that all principal is intact and a modest but continuous return has been earned on the portfolio. The par value of the General Fund investment portfolio for October 31, 2014 was \$6,302,516,494.41 as compared to October 31, 2013 when it was \$6,863,620,723.98. This is a decrease of over \$561 million dollars.

On October 31, 2014 the portfolio was earning an average of 1.006%, compared to 1.039% for the same date in 2013. The return reflects the diligence of the investment staff despite the impact of the Federal Open Market Committee maintaining the Fed Funds Target rate at .25% or less since December 16, 2008. For comparison, the three month constant maturity Treasury Bill averaged 0.023% from July 2014 until the end of October 2014 as compared with 0.036% for the same time period in the previous fiscal year. The low rate environment combined with the highly conservative portfolio strategy focused on liquidity to offset unpredictable and volatile cash flows has resulted in continued moderate but positive interest earned.

The General Fund gross interest earnings received year-to-date for fiscal year 2015 are \$18,603,385 compared to \$23,430,872 received for the same time period in fiscal year 2014. The almost \$5 million decrease in interest received is directly attributable to reduced cash balances available for investment and the historically low-rate environment.

The following chart tracks the impact of the legislation passed during the 2011 Session to reduce the number of individual agency accounts that receive an interest allocation from the total interest earned on the investment portfolio. It should be remembered that as the total General Fund portfolio decreases, the proportion of Agency Funds to General Funds increases and therefore their allocated share increases.

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	53,178,733	87,900,159	141,078,892	62%
2012	23,207,535	48,647,954	71,855,489	68%
2013	8,646,595	40,710,863	49,357,458	83%
2014	19,133,149	52,602,770	71,735,919	73%
OCT. 2015	253,383	18,350,002	18,603,385	99%

The Securities Lending Program continues to provide additional revenue. The program has earned \$67,733.42 so far in fiscal year 2015. This compares with \$85,925.98 for the same period in fiscal year 2014. The continued fortification of Bank Balance sheets and slower economic environment has reduced borrowers' need for the securities in the State's portfolio.

The Office continues to increase minority business participation in the investment of State funds. Twenty-four MBE broker/dealers are on the Office's approved list for fiscal year 2015 and they have handled investments of \$50 million out of \$149 million so far this fiscal year. This compares with fiscal year 2014, when the Office had twenty-two approved MBE broker/dealers who handled \$66 million out of \$324 million in investments by the end of October. In fiscal year 2014 over \$324 million had been invested by October 31, 2013 while only \$149 has been invested to date in fiscal year 2015. The marked decrease in investments is directly attributable to reduced available cash balances held by the State.

The Maryland Local Government Investment Pool (MLGIP) AAAM rating was reaffirmed by Standard and Poor's on September 29, 2014. The Pool balance at October 31, 2014 was \$3,926,312,538.83 compared with \$3,340,114,561.76 for the same date in 2013. This is an increase of over \$586 million dollars due to participants' higher available cash balances. The MLGIP is paying .03% as of October 31, 2014 compared to .06% last year. The 302 participants continue to use the Pool due to the lack of safe short-term investment alternatives for Investment Pool members at a comparable yield. The MLGIP is in total compliance with the 2010 changes in Money Market rules and regulations and preparing to comply with the proposed changes for October 2016. The MLGIP Advisory Board is monitoring all changes proposed by the SEC for Money Market Funds. The State Treasurer's Office has been very active lobbying the SEC and now GASB about proposed changes to the Funds and the way in which the changes might adversely impact local investment pools managed by states across the country.

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 recent Federal Government Shutdown created additional uncertainty about revenue streams. The State Treasurer's 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.

DEBT MANAGEMENT DIVISION

Ratings

On July 3rd and 7th, in conjunction with the sale of Maryland's General Obligation Bonds State and Local Facilities Loan of 2014, Series A, B and C, Moody's Investors Service, Standard & Poor's (S&P) and Fitch Ratings all affirmed their AAA ratings for Maryland's General Obligation debt. Maryland is one of only ten states to hold the coveted AAA rating, the highest possible rating, from all three major rating agencies. S&P has rated the bonds AAA since 1961. Moody's has assigned the bonds a rating of Aaa since 1973, and Fitch Ratings has rated the bonds AAA since 1993. The other nine states that hold AAA ratings from all three rating agencies are Alaska, Delaware, Georgia, Iowa, Missouri, North Carolina, Texas, Utah and Virginia. Previous to 2013 there were only eight states total that held AAA ratings from all three rating agencies as Texas received three AAA ratings in September 2013 and Alaska received three AAA ratings in January 2013.

Meetings with Rating Agencies

As of the date of this report, there have been no further rating actions. The Treasurer's Office has provided the rating agencies with regular updates on the financial condition of the State. The next conference call with the rating agencies is expected prior to the sale of the 2015 First Series General Obligation Bonds in March, 2015.

Ratings Reports

Generally there is consensus among the rating agencies in evaluating the State's credit strengths and weaknesses. All three major rating agencies cite Maryland's debt policies, fiscal management and economy as credit positives and the state's debt burden and pension funding as concerns.

Financial Management

All three rating agencies point to the State's history of strong, sound financial management as a credit strength. Moody's cites a "history of strong financial management" and "adequate reserve levels despite recent draws" as two of the three highlighted "strengths" of Maryland's credit profile. In assessing Maryland's management practices, S&P assigned a rating of "strong" to this factor, noting: "Long history of proactive financial and budget management, including implementation of frequent and timely budget adjustments to align revenues and expenditures." Fitch Ratings further said: "Financial operations are conservative, and the state maintains a well-funded rainy day fund. The state took repeated action during the course of the recession to address projected budget gaps, including raising tax revenues, cutting spending, and using rainy day and other balances."

Debt Policies and Debt Burden

In the case of all three rating agencies, the state's debt affordability guidelines and rapid amortization of debt are considered credit strengths and help offset concerns the rating agencies have regarding the state's debt burden. Fitch describes the state's debt management as "strong and centralized" and specifically highlights the debt affordability policies and the constitutional requirement to amortize debt within 15 years. Moody's states the constitutional limit "somewhat offset[s] the credit impacts of a high debt burden." The Capital Debt Affordability Committee is referred to as having a positive role in debt management by both Moody's and S&P with S&P stating "the clearly defined debt affordability process" has a positive stabilizing effect on the state's debt profile.

Economy

In assigning its 'AAA' long-term rating and stable outlook, S&P said: "The rating reflects what we view as the state's: Broad and diverse economy, and; High wealth and income levels." S&P further states: "The stable outlook on Maryland reflects our view of the state's proactive budget management in recent years and the economic recovery underway, although recent revenue growth has been hampered by events at the federal level." Fitch simply says "the state has a diverse, wealthy economy, benefiting from its proximity to the nation's capital". Fitch states Maryland's "diverse and wealthy service-oriented economy remains a source of credit strength", citing a lower than national unemployment and high personal income as strengths of the Maryland economy.

Each rating agency cites ties to the federal government as both benefits and risks to Maryland's economy. Moody's noted there has been decline in federal employment due to sequestration yet "the employment impacts on the state are less severe than nationwide." S&P noted "While federal fiscal policy remains a challenge to the state's budget and long-term financial plan, we believe that Maryland continues to monitor developments and has options to mitigate this risk based on its well-developed budget policies and financial reserves." In assessing the state's economy, Fitch indicated "[t]he state's economy has long benefited from proximity to the nation's capital, although the prospect of federal budget austerity poses a degree of uncertainty for the state's large federal agency presence and associated private contracting."

Pension and other liabilities

Pension reforms enacted during the 2011 Legislative Session, the teacher pension sharing enacted during the 2012 Legislative Session, and the phase-out of the corridor funding method that was enacted during the 2013 Legislative Session are noted by each of the three rating agencies. Fitch Ratings noted "Despite pensions being a comparative credit weakness, the state has taken multiple steps to reduce their burden and improve sustainability over time." Moody's indicated "The financial condition of Maryland's retirement system represents a credit challenge for the state" but goes on to recognize that "[t]he state has taken a number of measures to reduce its pension burden." While noting the reforms, including those enacted in 2013, the state's actuary projects "it would reach 100% funding by ... 2039." S&P indicated "[t]he state's below-average pension funded ratios continue to represent downside risk to the rating."

The State Treasurer's Office sends copies of the ratings reports for each bond sale to all members of the General Assembly and current reports are also available on the Treasurer's website at www.treasurer.state.md.us.

Closed Financings - General Obligation Bonds

Since our last report, the State has had one successful bond sale. The 2014 Second Series was sold on July 23, 2014 and totaled \$1,149,715,000. The proceeds were used to finance new projects and refund existing bonds. The sale closed on August 5, 2014 and had three series:

- Series A: \$50.4 million in Tax-Exempt Bonds sold in a negotiated sale with first priority to Maryland citizens
- Series B: \$449.6 million in Tax-Exempt Bonds sold in a competitive sale primarily to institutions
- Series C: \$649.8 million of Tax-Exempt Refunding Bonds

The Series A and Series B bonds provided \$500.0 million, at a historically low TIC (True Interest Cost) of 2.40%, to finance investments in capital projects critical to our State. The Series C refunding bonds saved taxpayers \$58.3 million in debt service costs. In addition, the State received a premium of \$70,389,283 to offset FY2015 debt service costs.

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 June 1, 2014 and October 10, 2014, \$2,003,801 in capital equipment was leased by State agencies through the State Treasurer's Office. On December 17, 2014, the State Treasurer's Office will finalize the financing of another equipment lease totaling \$1.7 million.

The Treasurer's Office also finances Energy Performance Leases in cooperation with the Department of General Services, providing funding for energy conservation improvements at State facilities. The program finances significant up-front investments in conservation projects; the lease is paid using the savings in operating costs. No energy leases were financed since our last report.

Upcoming Financing Plans

The next general obligation tax-exempt financing, projected to total approximately \$518 million, is planned for March, 2015. The State Treasurer's Office will consider whether a retail component will be offered in light of market conditions. Throughout the year, the Office monitors interest rates to gauge refunding opportunities that meet present value savings criteria in debt policy. If these benchmarks are met, refunding bonds could also be issued in March.

A Qualified Zone Academy Bond (QZAB) issuance is planned for December 2014. QZABs totaling \$4.6 million were authorized by the General Assembly in the 2014 regular

session. The federal authorization for these bonds requires that they be issued by December 31, 2014. These bonds are authorized as tax credit bonds.

Status of the Annuity Bond Fund

Debt service on General Obligation Bonds is paid from the Annuity Bond Fund and the primary source of revenue for this fund is real property tax receipts. Over the years, however, the debt service has also been supported on occasion by appropriations from the General Fund, as well. The Commission on State Debt met and released its annual report on April 7, 2014. In fiscal year 2015, \$140.0 million is appropriated from the General Fund to support debt service. Assuming current property tax rates are maintained and other assumptions remain as currently estimated, a continued General Fund subsidy is projected for fiscal years 2016 - 2019. The complete report is available on the Treasurer's website at:

<http://www.treasurer.state.md.us/debtmanagement/csd-reports.aspx>

Capital Debt Affordability Committee (CDAC)

General Obligation Recommendation

The Committee met on October 1, 2014 and considered a recommendation to maintain the authorization assumption projected in the 2013 CDAC Report. The Committee thus approved a total of \$1,170 million for new general obligation authorizations by the 2015 General Assembly to support the fiscal year 2016 capital program. The vote was 4-1, with the Comptroller voting against the proposed amount. The Committee specifically recognized that should the economic and fiscal information underlying its recommendation change significantly the Committee could reconvene and make any necessary modifications.

In addition to determining and recommending a prudent affordable authorization level for the coming year, the Committee also sets out planning assumptions for the State to use in its capital program planning process. The Committee's adopted planning assumptions project a similar amount in fiscal 2017 of \$ \$1,180 million. The planning assumptions in fiscal years 2018, 2019 and 2020 increase to \$1,275 million, \$1,315 million and \$1,355 million, respectively, and then decrease to \$1,320 million in fiscal year 2021. Beginning in fiscal year 2022, it is projected that the planning assumption will increase annually by approximately 3% over the previous year through 2024.

With these debt levels, the debt affordability ratios remain within the CDAC benchmarks of 4% debt outstanding to personal income and 8% debt service to revenues. The affordability analysis presented at the Committee's meetings indicates that the Committee's projection of General Obligation Bond authorizations will continue to be affordable (within debt guidelines) going into the future. The debt outstanding ratio peaks at 3.67% of personal income in fiscal year 2017 and declines to 3.42% in fiscal year 2024. The debt service ratio increases annually to 7.93% of revenues in fiscal year 2018 and declines to 7.77% in fiscal year 2020 before reaching 7.99% in fiscal year 2023.

The Committee recognizes that there are multiple annual authorization levels and patterns that would result in adherence to the benchmarks, depending on future levels of personal income and State revenue. The Committee's planning assumptions for future authorizations will be reviewed in preparation for the 2015 report in light of updated revenue and personal income projections and authorization levels may be adjusted to adhere to these affordability benchmarks.

Academic Facilities Bonds Recommendation

The budget committees requested that during the 2014 interim, as part of the Capital Debt Affordability Committee's review of the size and condition of the University System of Maryland (USM) debt (as required by § 8-112(e) of the State Finance and Procurement Article), the committee include an evaluation of the capacity to increase the amount of the USM Academic Revenue Bonds (ARB) by \$2,500,000 for each of the 2015 and 2016 legislative sessions for the purposes of providing additional authorizations to support USM capital projects.

CDAC has concluded that the overall level of debt is prudent over time and therefore recommends a limit of \$34.5 million for new academic facilities bonds for the University System of Maryland for fiscal year 2016. Morgan State University, St. Mary's College of Maryland, and Baltimore City Community College do not propose to issue bonds for academic facilities in fiscal year 2016.

The 2014 CDAC meeting materials and the Capital Debt Affordability Report are available on the State Treasurer's website at <http://www.treasurer.state.md.us/debtmanagement/cdac-reports.aspx>.

INSURANCE DIVISION

The Insurance Division is responsible for administering the State's Insurance Program which is comprised of 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, tunnels and roads, the Baltimore Washington International Thurgood Marshall Airport, the Port of Baltimore, Maryland Transit Administration liability, assorted professional liability exposures, and student athlete accident insurance. The State 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 is comprised of three Units: Underwriting, Loss Prevention, and Claims, which includes Tort Litigation. The Division's goal is to provide statewide risk management through loss protection (Underwriting), loss control (Loss Prevention), and loss restoration (Claims and Tort Litigation).

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 State-owned aircraft policy renewed effective June 30, 2014 with the incumbent carrier, AIG Aviation. The hull values were up from \$139 million to \$164 million due to the Maryland State Police Aviation Command taking delivery of more of the new fleet of AW-139 helicopters. Various sections went fully operational during the past year which also increased the premium. The annual broker fee was reduced in the most recent contract by \$19,000. With no rate change, no coverage change, and with values up 17.3%, the premium increased \$117,963.

The Maryland Transit Administration (MTA) excess liability coverage renewed effective July 1, 2014. MTA decided to renew with the double aggregate on the first layer of coverage, as expiring. The insurance market is getting rate increases and this renewal included a rate increase of 3.5%. Exposures were up less than 1%, and the premium increased \$133,054.

The Maryland Transit Administration (MTA) rail car property coverage renewed effective July 1, 2014. The rail car values were up by \$80,000,000 which is a 7% increase. There was no rate change but the renewal did include slight coverage improvements with some sub-limits increased. The renewal premium increased \$39,120.

The Maryland Aviation Administration (MAA) airport liability coverage for both BWI and Martin airports renewed effective August 15, 2014. BWI enplanements were up slightly. MAA was offered renewal quotes at the expiring limit of liability, \$500,000,000, and also an

option with a limit of liability of \$750,000,000, and MAA chose the higher limit. With \$250,000,000 more coverage, the premium increased \$31,381.

The statewide Boiler and Machinery coverage renewed effective September 30, 2014. The renewal values were up almost 6.1%. We changed carriers this renewal while maintaining our 20 days of infrared testing per year, gaining three carrier training classes per year, and all with a rate reduction of 7.3%. The expiring premium and broker fee was \$323,570, and the renewal premium and broker fee is \$319,000, saving the State \$4,570.

The three terrorism policies providing coverage for State-owned property exposures renewed October 13, 2014, with the same coverage and limits. The premium remained as expiring, even with recent world events.

The Maryland Transportation Authority (MDTA) liability coverage for toll bridges, tunnels, and the Inter County Connector renewed effective October 17, 2014. MDTA continued with the Law Enforcement Liability (LEL) to include the exposures at BWI airport, the Port of Baltimore, and the World Trade Center. There were no coverage changes, and with traffic down slightly and the number of officers up less than 1%, the renewal premium is saving MDTA \$22,194.

The Underwriting Unit frequently addresses agencies' questions about commercial insurance and self insurance coverage and has worked on special projects with more than 15 State agencies.

- Four State agencies, Maryland Port Administration, Maryland Aviation Administration, Maryland Public Television, and the Maryland Department of Business and Economic Development asked for assistance related to insurance issues regarding the recent Star Spangled Spectacular. Inquiries ranged from insurance coverage for the Star Spangled Spectacular, to the concert at Pier 6, the festival at Martin State Airport, and the fireworks launched from the World Trade Center roof.
- DHMH and MEDCO are working on the opening of a new public health lab later this year, and in September the Treasurer's Office, the broker, and the new Boiler and Machinery carrier went on a tour of the building to see its unique features. Another tour will be scheduled closer to opening when the equipment can be viewed running at a full load.
- Maryland Aviation Administration asked for insurance assistance because they will be borrowing two "plane mates" from MWAA's Dulles International Airport starting in mid October. The loan will be for two to three years while Baltimore Washington International Airport undergoes more construction in the international portion of the terminal. There are commercial liability and excess property policies involved, and our broker worked with our carriers to provide both the liability and property insurance required at no additional premium.

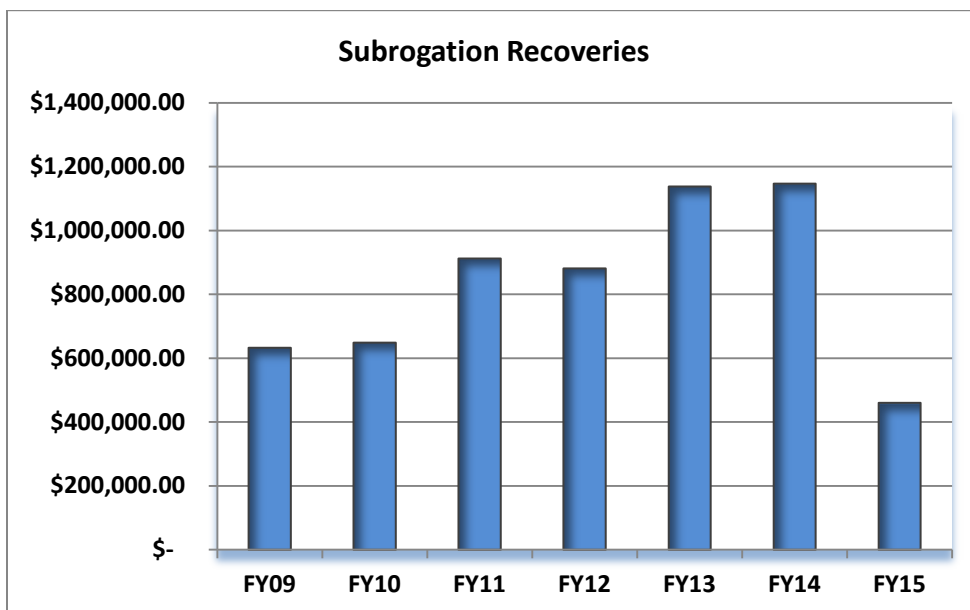
- Maryland Motor Vehicle Administration asked for assistance with insurance requirements for two currency counters they were preparing to lease/purchase.
- Maryland Public Television asked for assistance regarding the insurance requirements for a long term loan or lease agreement with a vehicle manufacturer.
- Ten State of Maryland schools were offered a webinar by our current insurance broker in advance of the athletic participant’s insurance renewal. The webinar was offered because of questions that had risen from changes related to the Affordable Care Act.

Claims

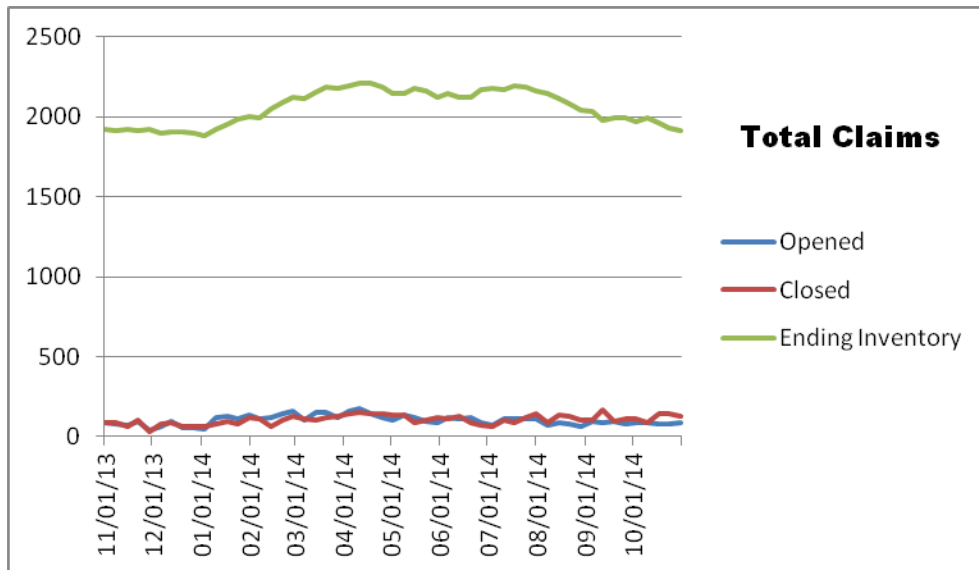
The Insurance Division’s Claims Unit investigates and resolves liability claims filed under the Maryland Tort Claims Act, Md State Gov’t Code Ann. §12-101 *et seq.* The Unit also handles claims for damage to State-owned property arising from sudden and accidental perils such as collision and comprehensive losses to autos, and a number of other perils such as fire, hail, lightning, and wind which may cause damage to State structures, equipment, and contents.

In addition to adjusting claims filed under the Maryland Tort Claims Act, the Unit is also charged with recovering the cost of damage to State automobiles and property caused by others. This subrogation recovery process helps to offset State Insurance Trust Fund liabilities and positively affects the Fund’s solvency. Since 2007, the Claims Unit has focused on increasing subrogation recoveries by designating specific claims personnel to pursue these debts.

The year-to-date subrogation recoveries total for fiscal year 2015 is \$460,127. The total recovery for fiscal year 2014 is \$1,147,263; which surpassed both fiscal year 2013’s recovery total of \$1,138,168 by 0.8% and fiscal year 2012’s recovery total of \$880,929 by over 30.2%.



In addition to subrogation activity, the open and closed claims are tracked to gauge activity and inventory. From November 1, 2013 through October 31, 2014, 5,199 claims were opened, and 5,288 claims were closed; which reflects a 1:1.02 open-to-close ratio.

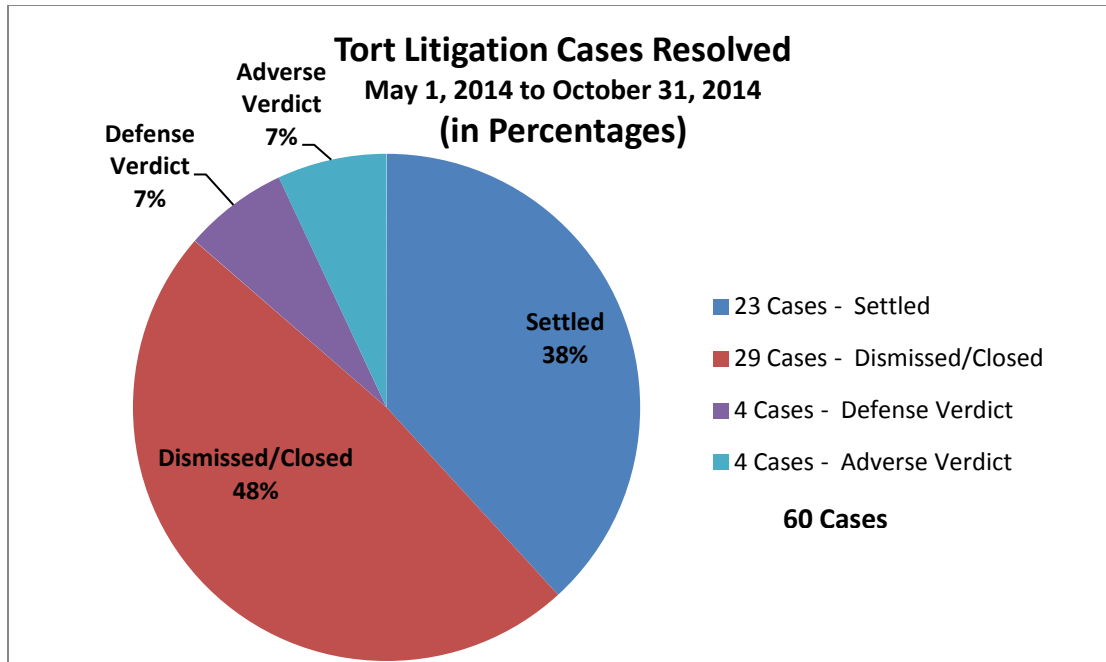


Tort Litigation Management

The Litigation Manager works closely with the Office of the Attorney General to proactively resolve cases in litigation. The Litigation Manager investigates, evaluates and extends settlement authority to the Assistant Attorneys General on behalf of the Treasurer. In cases valued over \$100,000, the Litigation Manager briefs the Insurance Review Committee which is comprised of the Chief Deputy Treasurer, the Supervising Tort Attorney, and other stakeholders.

The Litigation Manager also attends settlement conferences and other court mandated activities, along with providing updates on the status of certain litigation claims of interest. The Litigation Manager provides feedback to adjusters during the discovery process, upon resolution to help improve the adjusters’ investigation and develop strategies on similar claims that may arise.

The Tort Unit handles a rolling docket of approximately 110 - 120 litigation claims. The Litigation Manager actively monitors trial verdicts and appeals and assesses the potential impact on the State Insurance Trust Fund. The Litigation Manager also analyzes the data in order to track the litigation outcomes. The disposition of the cases disposed of between May 1, 2014 and October 31, 2014, is noted in the following table:



Loss Prevention

The aim of loss prevention is to help State agencies develop specific action plans and safety practices to mitigate or eliminate State agencies' most frequent or severe sources of preventable losses.

Annually, the Loss Prevention Unit conducts a comprehensive review of numerous State agencies' loss histories to identify problem areas and to help agencies with high severity and/or frequency claims take corrective measures. These efforts are expected to significantly reduce loss frequency and the severity of damage sustained to State-owned buildings and contents.

In June 2014, agencies and universities participated in a live webcast for a discussion on elements of a hurricane emergency plan, and precautions and preparations to take before, during, and after a major windstorm event. As required, Loss Prevention provides weather alerts (flood, hurricane, tornado and tropical storms), loss prevention checklists and recommendations to facility directors, maintenance personnel, safety officers, risk managers and insurance coordinators.

Monthly loss reports are distributed to the top agencies and universities with the highest claims frequency. Meetings are arranged with representatives from the agencies and universities to discuss their loss prevention programs, mitigation and claims handling. Specific topics include preventative maintenance, pre-loss activities related to weather events, facility self-audit inspections, contractor management, fire protection impairment programs, and claims impact. Between June and September 2014, State agencies and universities visited include MAA (BWI Thurgood Marshall Airport), MPA (World Trade Center), Bowie State University, University of

Maryland Baltimore (UMB), Towson University and University of Maryland College Park, Maryland Transportation Authority (MdTA), and Department of Natural Resources.

Other agencies and universities were visited by Loss Prevention in advance of the property and wind surveys performed by the State's excess property carrier. Guidance on property risk improvements, management programs and outstanding recommendations were discussed. Facility tours provided during the visits afforded Loss Prevention an opportunity to present other recommendations based upon observations that could be implemented before a property survey was conducted. Visits and tours took place at the Department of General Services (State House and State Office Building #1), Maryland Port Administration (World Trade Center), University of Maryland Eastern Shore and Salisbury University.

Following discussions with the Maryland Port Administration pertaining to the Star Spangled Spectacular, the Loss Prevention Unit and the State's insurance carriers for Boiler and Machinery and Excess Property, reviewed the risk assessment that was conducted by "Grucci", the fireworks display vendor and provided loss prevention and risk control recommendations in advance of the fireworks launched from the World Trade Center. The Loss Prevention Unit and the State's insurance carrier for Aviation Liability provided assistance to the Maryland Aviation Administration for the festival at Martin State Airport. STO provided follow up with both agencies and toured Martin State Airport to ensure recommendations were implemented prior to the commencement celebration.

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.