



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

**June 1, 2014**

**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 December 17, 2013. 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 December 1, 2013 and May 31, 2014, the Board of Public Works (“BPW”) met 12 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, the following items worthy of note were considered by the Board of Public Works:

### **Capital Equipment Lease-Purchase Financing**

- The Legislative Policy Committee (“LPC”) approved the request of the State Treasurer periodically to lease-finance capital equipment acquisitions in an aggregate amount not to exceed \$35 million over a three-year period beginning July 1, 2013 and ending June 30, 2016. The BPW approved the following lease-purchase equipment financing consistent with this authorization:
  1. December 2013 Tax-Exempt Equipment Lease-Purchase Agreement for financing the acquisition of \$369,247 of capital equipment with a 1.169% weighted average interest rate for the winning bid. (12/04/13)
  2. February 2014 Tax-Exempt Equipment Lease-Purchase Agreement for financing the acquisition of approximately \$255,021 of capital equipment with a 1.170% weighted average interest rate for the winning bid. (02/19/14)
  3. June 2014 Tax-Exempt Equipment Lease-Purchase Agreement for financing the acquisition of approximately \$1,803,645 of capital equipment with a 1.240% weighted average interest rate for the winning bid. (05/28/14)
- Following the most recent financing (June 2014), the total amount financed during the 3-year authorization period is approximately \$3.1 million. The remaining balance of the LPC authorization for equipment lease-purchase financing is approximately \$31.9 million.

### **Public School Construction**

- State School Construction – Capital Improvement Program (CIP) for FY 2015: Approved allocations totaling \$325.3 million. (05/14/14)
  - Incorporates \$187.5 million approved by the BPW on February 5, 2014.
  - Approval at the May 14, 2014 BPW meeting was given for:

- Additional projects in the amount of \$131.3 million; and
  - \$6.5 million in FY 2014 Air Conditioning Initiative reserved funds.
- The FY 2015 CIP includes \$275 million of new bond authorizations, \$6.5 million from the FY 2014 Air Conditioning Initiative Reserves, and \$43.8 million in reverted funds from the Statewide Contingency Account.
- Aging School Program for FY 2015: Approved allocations totaling \$7.9 million. (05/14/14)
- Qualified Zone Academy Bond Program for FY 2015: Approved allocations totaling \$6,429,000. (05/14/14)

### **State Services and Facilities**

- Approved the modification of the State's Pharmacy Benefits Plan Management and Prescription Coverage for employees, retirees, and their respective eligible dependents to permit Medicare-eligible State retirees to be enrolled in the Medicare Part D Employer Group Waiver Plan. (12/18/13)
- Approved a request of the Maryland Public Service Commission to award a consultant contract to assist the Commission's Technical Staff in altering the Maryland Renewable Energy Portfolio Standard Program to include offshore wind energy. (12/18/13)
- Approved a request of the Maryland State Department of Education (MSDE) to award a contract to provide comprehensive project management services and grant support activities necessary to allow the Partnership for the Assessment of Readiness for College and Career (PARCC) consortium to successfully execute all purposes of the United States Department of Education's Race to the Top Assessment program grant by developing a common assessment tool. (12/18/13)
- Approved the award of a contract for statewide dental services for inmates in the custody of the Department of Public Safety and Correctional Services. (02/19/14)
- Approved a request of the Maryland Energy Administration (MEA) to award a consulting and energy related services contract to assist MEA in the implementation of the Community Wind Service Program. (03/19/14)
- Declared as surplus approximately three acres of University of Maryland, College Park land that the University proposes to sell to the UMCP Foundation for private development as a University hotel and conference center. (03/19/14)
- Approved a lease between the State of Maryland and the United States Postal Service for the USPS use of the Historic Annapolis Post Office located at 1 Church Circle for a period of 8 – 20 months. (12/18/13)

- Approved a cross easement and termination agreement relating to property (part of the Northwood Shopping Center property) that Morgan State University is developing for its new business school and other future projects. (03/05/14)
- Approved the granting of a perpetual security easement to the United States General Services Administration as part of the proposed FBI Headquarters relocation to Greenbelt. The easement area will be located on a portion of the Greenbelt Metro property. (03/05/14)
- Approved the request of the University of Baltimore to enter into an exchange agreement with the United States Postal Service to acquire a 2.5-acre parcel of land in Baltimore City (Oliver Street) for the purpose of future University development and completion of its 10-year Campus Master Plan. (03/19/14)
- Approved a request to dispose of 11.82 acres of land that constitute the Cambridge Marine Terminal that was declared as surplus after BPW approval at its December 4, 2013 meeting. The property will be transferred to the City of Cambridge which will oversee a local economic development project on the site. (04/30/14)
- Declared as surplus 3903 Greenway Avenue, Baltimore City, a property formerly used as the Towson University president's residence. Towson University will offer the property for sale and will return to the BPW when an acceptable offer is selected. (05/28/14)
- Approved a 25-year lease of 17 +/- acres in Seneca Creek State Park between the Department of Natural Resources and Warrior Canine Connection, Inc. (WCC) The property will be used by WCC as a therapeutic vocational training center for transitioning and recovering military members. WCC rescues, rehabilitates, and trains shelter dogs to become service animals in support of helping wounded military service men and women recover from the effects of Post-Traumatic Stress and other physical and mental disorders arising from their military service to the United States of America. (05/28/14)

### **Information Technology**

- Approved the award of a contract to implement an integrated statewide personnel system using a multi-tenant, cloud based human capital management solution. (12/18/13)

### **BWI Marshall Airport**

- Approved a request of the Maryland Aviation Administration to award a contract to construct a three level addition at the end of the International Concourse E. (03/19/14)

- Approved a request of the Maryland Aviation Administration to proceed with a contract as an expedited procurement for the replacement of baggage handling equipment in Terminal A/B at BWI Marshall. (04/16/14)
- Approved a request of the Maryland Aviation Administration to proceed with a contract as an expedited procurement for design services for runway improvements in order to take advantage of federal funding. (04/02/14)
- Approved a standard use and lease agreement and promotional contracts to be offered to carriers at BWI Marshall Airport. Approval was given for:
  - New standard Use and Lease Agreement for Southwest Airlines and as a prototype agreement for all signatory airlines;
  - Promotional contracts for non-signatory airlines that introduce new air service to domestic and international markets from BWI Marshall; and
  - Promotional contracts for signatory airlines that introduce new air service to domestic and international markets from BWI Marshall. (04/16/14)

### **State Property Tax Rate**

- Set the State Real Property Tax Rate based upon the recommendation of the Commission on State Debt. The rate remained unchanged at 11.2 cents per \$100 of the full assessed value of real property other than that of public utilities and 28.0 cents per \$100 of the full assessed value of real property of public utilities. (04/16/14)

### **Bonds**

- Adoption of a Resolution for the sale of \$737,410,000 2014, First Series State of Maryland General Obligation Bonds:
  - Competitive Sale: \$450M in tax-exempt bonds + \$50M in taxable bonds
  - Competitive Sale: Refunding Bonds: \$237,410,000
 (03/05/14)
- Approved a request by the Maryland Department of Transportation to adopt a resolution authorizing the issuance and sale of MDOT Consolidated Transportation Bonds, Series 2014 in an amount not to exceed \$150 million. Public sale will occur on or before June 30, 2014. (05/14/14)
- Adopted resolutions authorizing the sale of State of Maryland Qualified Zone Academy Bonds of 2013 in the amount of \$4,549,000. (12/18/13)
- Approved the Maryland Stadium Authority issuing \$8,635,000 in non-tax supported Revenue Bonds (Series 2013 Refunding Revenue Bonds) to repay the outstanding principal balance on the Camden Yards Sports Complex Taxable Revenue Bond Series 2010. (12/04/13)

## **Personnel & Procurement**

- Personnel: “Rule of 100”: Pursuant to Section 7-236 of the State Finance & Procurement Article and Section 31 of the Budget Bill for 2014 (HB 100), the Board of Public Works is authorized to create no more than 100 additional State funded positions during FY 2014. The following actions were taken as a result of this authorization:
  - Approved the creation of four specially funded positions within the Maryland Energy Administration. These positions are required to enable MEA to meet increased program requirements being funded by increased revenues from the Regional Greenhouse Gas Initiative auctions. These revenues will enable MEA to expand current programs designed to make progress towards the State’s EmPOWER Maryland and Renewable Portfolio Standard goals. (04/30/14)
  - Approved the creation of one full-time position within the Department of Veterans Affairs to serve as an Administrative Assistant at the Charlotte Hall Veterans Home. This position has been filled with contractual personnel since 2007. Frequent turnover and a lack of interest of qualified personnel in this contractual position because of the lack of benefits necessitate this full-time position request. (05/14/14)
  - Approved the creation of two full-time equivalent positions within the Department of Budget and Management to implement the statewide Learning Management System that will assist with the training for the new statewide personnel system. DBM intended to hire two contractual employees to perform these functions but the lack of benefits impacted the level of interest in the contractual positions. (05/28/14)
  - Approved the creation of two new positions within the Office of Administrative Hearings (OAH). OAH intends to convert two contractual Administrative Law Judge (ALJ) positions into two ALJ State positions. Because contractual ALJ positions have no benefits, OAH experienced difficulty recruiting and retaining satisfactory candidates for the contractual positions. (05/28/14)
  - With approval of these four requests during this reporting period, 33.7 positions have been approved within the Rule of 100 for FY 2014.
- Approved for final adoption new regulations and amendments to existing COMAR provisions to implement legislation enacted during the 2012 and 2013 General Assembly Sessions. The regulations will:
  - Establish environmental standards for State purchases of electronic products. (Chapter 372, Laws of 2012)
  - Establish procurement preferences for services provided in the United States. (Chapters 559/560, Laws of 2012)

- Prohibit a prime contractor on a State contract from creating more stringent bonding requirements for subcontractors than those imposed by the State. (Chapters 504/505, Laws of 2013)
- Change the definition of architectural services and engineering services and require separate MBE reporting for each service. (Chapter 138, Laws of 2013)
- Impose requirements for agency reporting on contracts with preferred providers. (Chapters 343/605, Laws of 2013) (03/19/14)
- Approved for final adoption amendments to existing COMAR provisions relating to Standard Travel Regulations to establish the State Travel Management Program under the jurisdiction of the Secretary of Budget and Management. (05/14/14)
- Approved publishing for comment in the *Maryland Register* amendments to existing COMAR provisions relating to State agency purchases of commodities from Department of General Services statewide contracts. The proposed regulations will expand the opportunities for agencies to purchase outside of the statewide contracts. (03/19/14)
- Approved publishing for comment in the *Maryland Register* a new regulation to implement legislation enacted during the 2013 General Assembly Session. The regulations will establish procurement preferences for American-manufactured goods. (Chapters 437/438, Laws of 2013) (04/30/14)

### **Lottery & Gaming**

- Approved the request of the MD State Lottery & Gaming Control Commission to award a contract to provide Veterans' Organizations with instant ticket lottery machines and related services. (02/19/14)
- Approved a request of the MD State Lottery & Gaming Control Agency to modify the contract to provide a Lottery On-Line Gaming System to allow the contractor to provide a Loyalty Rewards Program that includes on-line games as well as instant ticket games. (03/05/14)
- Approved a request of the MD State Lottery & Gaming Control Commission to extend the current contract for the provision of investigative services for the purpose of conducting criminal and non-criminal background investigations for Applicants to be licensed under the Video Lottery Terminal program. The time extension is necessary to assist with additional investigations needed for the Prince George's County VLT Facility. (04/16/14)

### **Environmental Programs & Natural Resources**

- Approved the acquisition of a perpetual conservation easement on 421 acres along the Augustine Herman Highway in Kent County. This acquisition is in support of the Chesapeake Country National Scenic Byway. (12/04/13)

- Approved the acquisition of a conservation easement to protect approximately 171 acres of the Grove Neck Girl Scouts Camp in Cecil County at the confluence of the Sassafras River and the Chesapeake Bay. (02/19/14)
- Approved the use of Program Open Space funding for the acquisition in fee simple of approximately 182 acres located in Charles County. The property comprises a deciduous forest and buffers a stream that is a tributary of the Potomac River. The property will be managed by DNR's Wildlife and Heritage Service as part of the Nanjemoy Natural Resource Management Area. (04/02/14)
- Approved the award of a contract to construct the Kenilworth Gardens Segment of the Anacostia Riverwalk Trail, the final segment of the 60 mile Anacostia Riverwalk Trail. (12/18/13)

## **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 completed the conversion of all lockbox processing to the current statewide lockbox provider; Citibank N.A. Many enhancements have been added to the lockbox processing, improving reconciliation processes at the State. Total business process improvement at the agencies continues.

The Department procures financial products and services statewide. During the past six months, BSD conducted procurement on behalf of The College Savings Plans of Maryland to provide services for the accounts and assets under the control of the Board, including depository, disbursements, lockbox and custodial services. The Department continued the implementation process for the new Agency Depository Contracts for statewide banking depository services. It is anticipated that almost 500 agency bank accounts will have to be moved to the newly designated depositories.

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 2013, total cash receipts and disbursements exceeded \$157 billion. As of April 30<sup>th</sup> total cash receipts and disbursements exceeded \$90 billion. 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 has been working with the Office's Information Technology Division and the State's Disbursement Bank (M&T Bank) to implement Payee Positive Pay for the disbursement accounts and open a Controlled Disbursement Account. During the enhancement process, State Checks were streamlined for Optical Character Readers and now have a much cleaner appearance. Payee Positive Pay was implemented May 1, 2014. This process has already improved control over fraudulent checks presented to the disbursement account. The Controlled Disbursement Account will go live July 1, 2014 concurrent with the beginning of the 2015 fiscal year.

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, BSD monitors over 1,800 agency bank accounts at 23 financial institutions. Total posted collateral as of April 30, 2014 was \$646+ million. The annual Bank Account Survey is being automated for security and efficiency. The survey is a verification tool used to ensure all accounts are collateralized appropriately and monitored monthly. The survey will be sent out during the month of June to update all open accounts and 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 posted two statewide policies to the website for agency reference. The Remote Deposit Policy and the Undeliverable/Unpresented Check Funds Policy are now posted to the Treasurer's website for easy access by all. 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 April 30, 2014 was \$6,123,432,943.26 as compared to April 30, 2013 when it was \$6,053,802,227.63. This is an increase of \$70 million dollars.

On April 30, 2014 the portfolio was earning an average of 1.059%, compared to 0.936% 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 0.045% from July 2013 until the end of April 2014 as compared with 0.089% 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 2014 are \$56,353,238 compared to \$41,242,436 received for the same time period in fiscal year 2013. The over \$15 million increase in interest received in this low-rate environment is directly attributable to continued daily vigilance in seeking out prudent investment opportunities.

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**

<b>Fiscal Year</b>	<b>Net General Fund</b>	<b>Allocated to State Agencies</b>	<b>Total</b>	<b>% of Total Allocated to State Agencies</b>
<b>2000</b>	121,951,720	103,173,287	225,125,007	46%
<b>2001</b>	136,981,074	144,249,899	281,230,973	51%
<b>2002</b>	82,641,807	66,399,769	149,041,576	45%
<b>2003</b>	37,205,637	42,240,523	79,446,160	53%
<b>2004</b>	25,037,345	29,053,449	54,090,794	54%
<b>2005</b>	52,886,074	54,538,463	107,424,537	51%
<b>2006</b>	149,613,238	109,222,108	258,835,346	42%
<b>2007</b>	150,798,001	205,589,917	356,387,918	58%
<b>2008</b>	155,170,184	207,179,098	362,349,282	57%
<b>2009</b>	102,768,740	142,619,087	245,387,827	58%
<b>2010</b>	44,190,425	87,921,654	132,112,079	67%
<b>2011</b>	53,178,733	87,900,159	141,078,892	62%
<b>2012</b>	23,207,535	48,647,954	71,855,489	68%
<b>2013</b>	8,646,595	40,710,863	49,357,458	83%
<b>APR 2014</b>	12,697,369	43,655,869	56,353,238	77%

The Securities Lending Program continues to provide additional revenue. The program has earned \$213,598.94 so far in fiscal year 2014. This compares with \$364,009.36 for the same period in fiscal year 2013. The continued overall economic market slow-down during the last quarter 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 2014 and they have handled investments of \$150 million out of \$761 million so far this fiscal year. This compares with fiscal year 2013, when the Office had twenty-two approved MBE broker/dealers who handled \$622 million out of \$6,049 billion in investments by the end of April. In fiscal year 2013 over \$6,049 billion had been invested by April 30, 2013 while only half a billion has been invested to date in fiscal year 2014. The marked decrease in investments is directly attributable to the shift in the interest rate environment in reaction to the tapering of the Fed's "quantitative easing"

program. The wind down of the program severely impacted the pace of calls of agency paper due to the anticipated rising interest rate environment.

The Maryland Local Government Investment Pool (MLGIP) AAAM rating was reaffirmed by Standard and Poor's on March 31, 2014. The Pool balance at April 30, 2014 was \$3,603,166,747 compared with \$2,861,962,915 for the same date in 2013. This is an increase of over \$741 million dollars due to participants' higher available cash balances. The MLGIP is paying .06% as of April 30, 2014 compared to .10% 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 contract with PNC Bank, the administrator of the MLGIP, was renewed December 31, 2013 after they were selected as the best Offeror during the RFP process. The MLGIP is in total compliance with the 2010 changes in Money Market rules and regulations. 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 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. It is expected that the SEC will issue new regulations this summer.

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 February 19<sup>th</sup>, in conjunction with the sale of Maryland's General Obligation Bonds State and Local Facilities Loan of 2014, First Series A, B and C, the Treasurer announced that 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. Standard and Poor's 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, before Alaska received three AAA ratings in January 2013 and Texas received three AAA ratings in September 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 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 2014 Second Series General Obligation Bonds in July, 2014.

#### *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 strength for Maryland. 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, Standard & Poor's assigned a rating of "strong" to this factor, noting: "Based on a review of several key financial practices, Maryland has made continuing efforts to institutionalize sound financial management practices. In reviewing its practices and policies, the state's use of a five-year financial plan, which is updated annually with the adopted budget, provides the basis for future fiscal decisions and recognizes future fiscal year gaps. Monthly monitoring and reporting of key revenues allows the state to make midyear financial adjustments, if necessary, to maintain balance. Maryland has consistently maintained its statutory RSF at or above its legal minimum of 5% of revenues." 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 relative to 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 Standard and Poor’s with Standard and Poor’s stating the debt affordability process has a positive stabilizing effect on the State’s debt profile.

### *Economy*

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” economy is a credit strength, citing employment growth, lower than national unemployment, high personal income as strengths of the Maryland economy. In assigning its ‘AAA’ long-term rating and stable outlook, Standard & Poor’s said: “The rating reflects what we view as the state’s broad and diverse economy, which has experienced steady recovery; high wealth and income levels; ...” Standard and Poor’s 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, which has stabilized revenues.”

Each rating agency cites ties to the federal government as both benefits and risks to Maryland’s economy. Moody’s states that based on the large federal presence in and near Maryland, there is a “large percentage of well-paid residents employed by the federal government”, but notes that, while the federal employment benefits the state’s economy, federal deficit reduction measures pose a risk to the state’s economy. 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 actively 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 near-term 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 “Although pension funded ratios are weak, the state has undertaken multiple reforms to return to full funding 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.” S&P indicated “[t]he state’s below-average pension funded ratios continue to represent downside risk to the rating.”

Each of the rating agencies have noted that any “falling away” from the pension reforms and employer funding plans imbedded in the funding projections when the reforms were adopted would be a sign for concern. Moody’s most recent report lists, “Failure to adhere to plans to address low pension funded ratios” as a factor that “could make the rating go down.” Standard and Poor’s specifically note in their last report that, “Although various reforms have been implemented, the state does not fully fund its ARC, which, along with weak investment returns, has significantly lowered the funded ratio.”

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](http://www.treasurer.state.md.us).

### **Closed Financings - General Obligation Bonds**

Since our last report, the State has had one successful bond sale. The 2014 First Series was sold in a competitive sale on March 5, 2014 and totaled \$736,855,000. The proceeds will finance necessary capital projects, such as schools, community colleges, university projects and hospitals and refund existing bonds. The sale closed on March 18, 2014 and had three series.

The First Series A bonds were tax exempt and provided \$450.0 million, at a true interest cost of 2.84%. The First Series B bonds were taxable and totaled \$50.0 million. The First Series B bonds were issued in short maturities in order to capitalize on the lowest point of the yield curve and resulted in a true interest cost of 0.91%. The First Series C tax exempt refunding bonds totaled \$236.6 million and saved taxpayers \$12.6 million in interest 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 December 13, 2013 and February 28, 2014, \$624,268 in capital equipment was leased by State agencies through the State Treasurer’s Office. On June 6, 2014, the State Treasurer’s Office will finalize the financing of another equipment lease totaling \$1.8 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 \$500 million, is planned for July, 2014. 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 July.

### **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)**

The CDAC will be meeting during the summer of 2014 in order to complete its review of State debt and make recommendations on the total amount of new State debt and new bonds for academic facilities that prudently may be authorized for the next fiscal year. Meeting materials and the final 2014 CDAC Report will be available on the Treasurer's website.

## **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, 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 Unit**

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's liability coverage was renewed on January 31, 2014. The broker shopped the coverage to the incumbent carrier and four others. There was a lot of interest and competition from the carriers trying to write our account this year. The Port's revenue is estimated to go up 5.2% in 2014. As compared to the expiring premium, and with estimated revenue growth, MPA saved \$74,971 on this renewal.

The Underwriting Unit buys marine liability insurance to cover State-owned watercraft. The number of vessels is up from last year's 1,062 to 1,125 for 2014. The broker fee increased this year with the contract renewal. The marine market was seeking rate increases this year, and our rate went up 5.79%. With 63 more vessels, and the broker fee increase, our total cost went up \$7,949.

The Statewide excess property coverage renewed April 1, 2014. The broker shopped our coverage to seven carrier seeking rate increases in the range of 10%-15%. The State of Maryland has had a few property claims, and the UMES greenhouse fire claim is still open, which is a large loss. We renewed with the incumbent lead carrier Lexington, and their quote will include seven property inspections for the 2014-15 renewal. The renewal property values were up 7%. The broker was able to negotiate a

slight rate reduction (less than 1%) even with our losses. With market conditions and our values up \$2,026,511,582, our premium only went up \$261,771.

The Maryland Port Administration's auto liability insurance coverage, effective January 1, 2014, was marketed to the incumbent carrier, Selective, and three other carriers. The number of vehicles has not changed from the expiring policy. The insurance market is not as competitive for this type of risk and is seeking rate increases. The expiring premium and broker fee was \$68,502. The renewal premium (up 1.7%) and broker fee is \$69,530, for a total increase of \$1,028.

The Maryland Aviation Administration's (MAA) annual meeting was held March 26, 2014, at BWI Airport to include representatives of MAA, our insurance broker, three insurance carrier representatives, members of the Underwriting, Claims, and Loss Prevention Units, and the Director of Insurance, in advance of the August 2014 policy renewal. There were nine open claims that were discussed. Only two of the claims had any reserves of significance. The exposures at Martin State Airport for the upcoming Star Spangled Spectacular in September 2014 were discussed, and the carrier's loss control representative offered her services with conference calls and a pre-event inspection. We also discussed the status of the current construction project and the upcoming construction projects. The carrier indicated the insurance market conditions are good, and we can expect no rate increases for the upcoming renewal.

The Maryland State Police Aviation Command annual meeting was held at their headquarters in Middle River on May 15, 2014. The purpose of the annual meeting is to discuss the status of the new helicopters and the related training, the old helicopters, review claims activity, and discuss the aviation market conditions and expectations for the upcoming June 30, 2014 renewal.

The Underwriting Unit frequently addresses agencies' questions about commercial insurance and self insurance coverage and has worked on requests with at least ten State agencies:

- Morgan State University (MSU), the Maryland Aviation Administration, and the Department of Budget and Management requested our assistance on minimum insurance requirements.
- Maryland Transit Administration requested, and we participated in a conference call regarding the Purple Line.
- Maryland Emergency Management Association and the Department of Information Technology requested data from us regarding State-owned buildings for current projects in the works.
- University of Maryland Center for Environmental Sciences asked for assistance to insure a "Teledyne Webb Glider" which was purchased to help assist them with storm intensity forecasting needs in the Northeast USA.
- Baltimore City Community College and University of Maryland Baltimore County made inquiries regarding the American Heart Association Training Centers they are operating on their campuses.

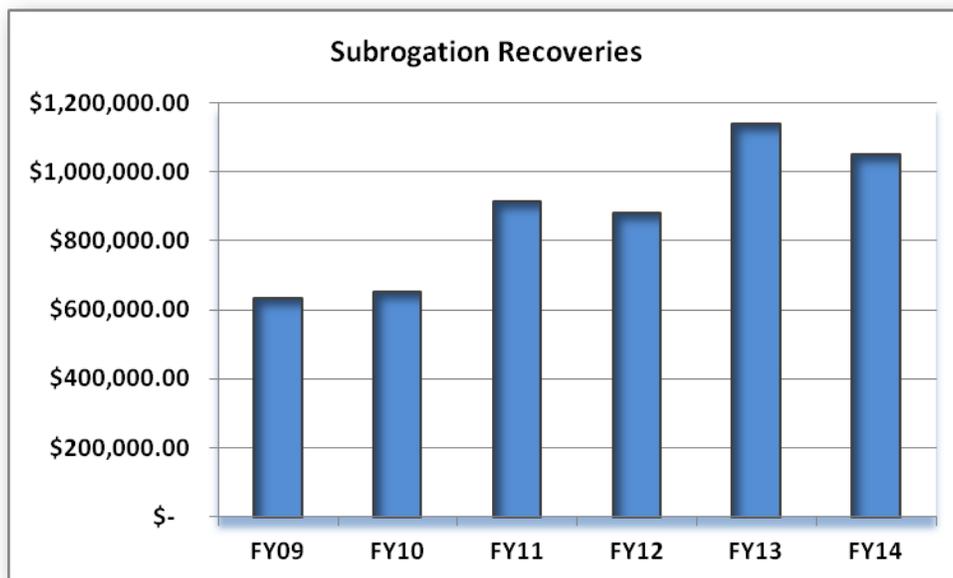
- University of Maryland College Park requested information on travel accident insurance for their employee’s domestic and foreign travel.

**Claims Unit**

The 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 damages 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.

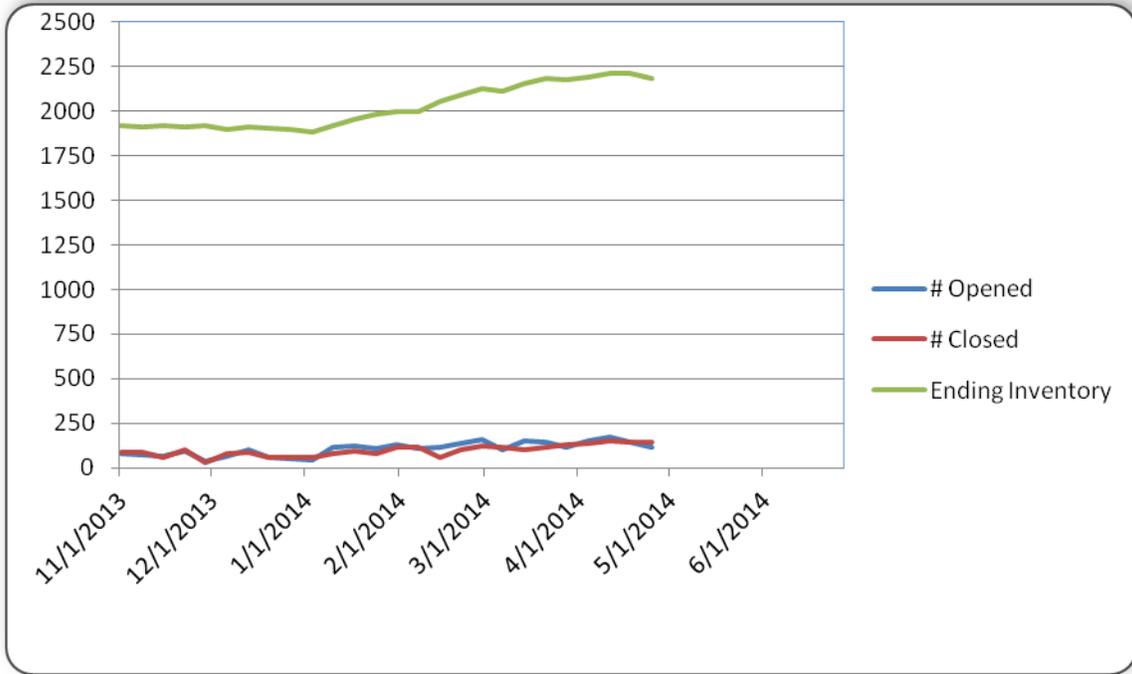
In addition to adjusting claims filed under the Maryland Tort Claims Act, the Unit is also charged with recovering the cost of damage to State automobiles and property caused by others. This subrogation recovery process helps to offset State Insurance Trust Fund liabilities and positively affects the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

The year-to-date subrogation recoveries as of April 30, 2014, for fiscal year 2014, is \$1,047,435.59, which is in line to exceed the total subrogation of \$1,065,002 in fiscal year 2013; which surpassed both fiscal year 2012’s recovery total of \$880,929 and fiscal year 2011’s recovery total of \$912,156 by over 15%.



In addition to subrogation activity, the open and closed claims are tracked to gauge activity and inventory. From November 1, 2013 through April 30, 2014, 2,801 claims were opened, and 2,529 claims were closed; which reflects a 1:11 open-to-close

ratio. This minimal increase was due to the harsh and recurring winter weather and the extreme cold conditions.



**Joint Collaborations with Claims and Loss Prevention:**

In fiscal year 2014, the Loss Prevention and the Claims Unit began conducting monthly and quarterly loss reviews. Monthly loss summary reviews are now being completed and distributed to agencies with frequent or severe claims to assist the agencies with any current loss, accidents trends, reporting processes and supports required, preventable losses, etc. Meetings have and will be scheduled, as needed with agencies having the highest loss frequencies recorded monthly and/or quarterly. The Loss Prevention and the Claims Unit met with the Maryland Transportation Authority, the State Highway Administration and the Department of Public Safety and Correctional Services to provide an overview of the Insurance Division and to discuss claims frequency, preventable accidents related to road hazards, maintenance, operations and contractors.

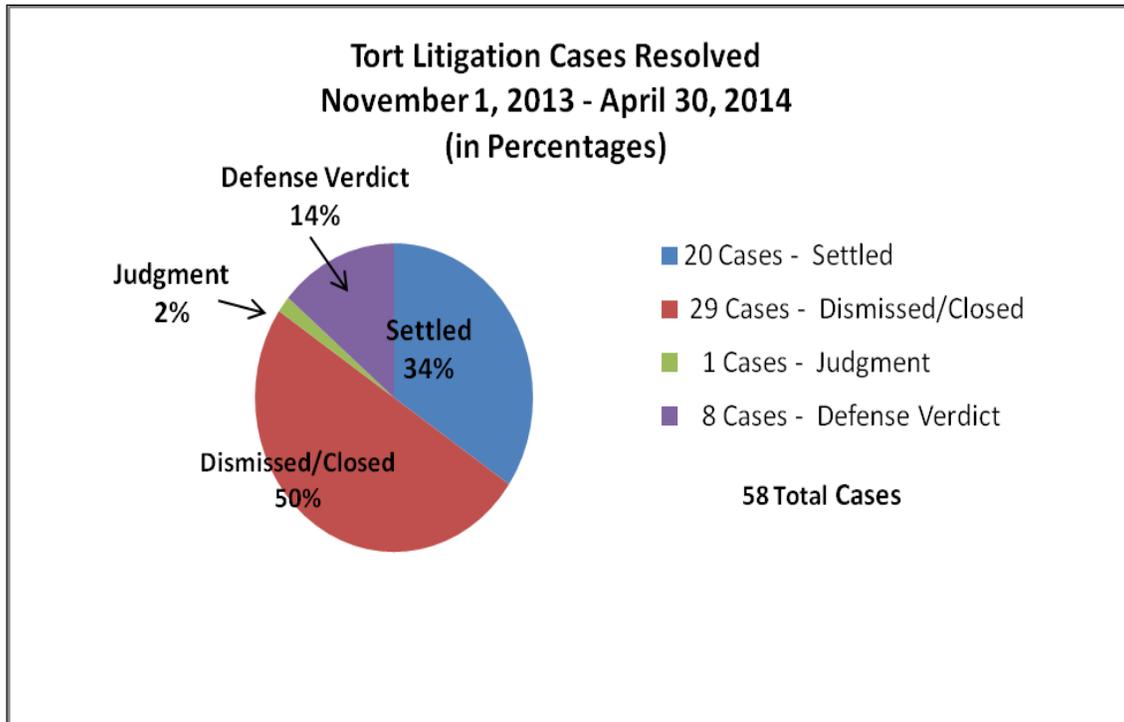
**Tort Litigation Management**

The Director of Insurance works closely with the Office of the Attorney General to proactively resolve cases in litigation. The Litigation staff investigates, evaluates and extends settlement authority to the Assistant Attorneys General on behalf of the Treasurer. In cases valued over \$100,000, the Litigation staff briefs the Insurance

Review Committee which is comprised of the Chief Deputy Treasurer, the Supervising Tort Attorney, and other stakeholders.

The Director of Insurance attends settlement conferences and other court mandated activities providing updates on the status of certain litigation claims of interest. Feedback is provided to adjusters during the discovery process to help improve the adjusters' investigation and develop strategies on similar claims that may arise.

The Tort Unit handles a rolling docket of approximately 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 November 1, 2013 and April 30, 2014, is noted in the following table:



### Loss Prevention Unit

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.

The Loss Prevention Unit provided State agencies and universities with loss prevention and control strategies that if implemented may eliminate or minimize losses to State-owned property. One of the strategies provided pertains to the implementation of a fire protection impairment program. The purpose of the program is to establish a reasonable level of safety for property protection and building occupants during times when fire protection systems are off-line for the purpose of alteration, repair, or construction. Agencies such as the Department of Public Safety and Correctional Services, the Department of Health and Mental Hygiene, the University of Maryland Baltimore County, and the University of Maryland, University College have agreed to implement, or have completed implementation of the program.

This year, due to the unusual number of winter storms, the Loss Prevention Unit sent alerts whenever weather related events were forecasted to the facility directors, maintenance personnel, safety officers, risk managers and insurance coordinators for the State agencies and the universities to include pre-planning measures, cold weather precautions and checklists for storms and snow loading, and post-loss mitigation measures. The winter storms and the atypical cold weather resulted in an increase in claims, such as frozen pipes, road hazards, plowing incidents, etc. Loss Prevention analyzed claims trending, attended inspections and followed-up with the State agencies as needed.

Seven new property inspections are to be conducted in 2014 – 2015. The Loss Prevention Unit is currently scheduling property inspections to be conducted at BWI Airport (Terminal, Offices & Garages); M&T Bank Stadium; Oriole Park-Camden Yards; State House; Columbus Center; Towson Marriott Hotel and Conference Center, and 301 West Preston Street.

In March 2014, the Loss Prevention Unit participated in an auto loss control survey conducted by the current commercial auto liability carrier, of the Maryland Port Administration's (MPA) Fleet Management Program. The survey results were very favorable and the insurance carrier informed the State that MPA's program is considered better than similar risks in its class.

In February 2014, Loss Prevention met with the current Boiler and Machinery carrier and their vendor for electrical infrared testing to discuss the strategy for 2014. The testing identifies potential equipment failures and loose connections that create heat that can be imaged to show the exact location of a threat so that appropriate action can be taken before costly repairs and downtime are incurred. The 2014 strategy includes the following participating agencies and universities: the Department of Juvenile Services, the State Highway Administration, the Stadium Authority (Hippodrome), the Maryland Port Administration, the Maryland Food Center Authority, the University of Maryland Center for Environmental Science and the Maryland School for the Deaf. While many agencies and universities have the test conducted by an outside vendor, others such as the University of Maryland Eastern Shore, the Department of Juvenile Services, the

Baltimore Public Buildings and Grounds, and the Department of Public Safety and Correctional Services (Eastern Correctional Institute), recently purchased infrared testing equipment with plans to conduct the testing in-house.

Boiler and Machinery inspections, where the State agency has a code violation are forwarded to the Loss Prevention Unit within 30 days after the inspection. The report identifies the actual code violation; any improvement actions; compliance and follow-up inspection dates. Inspections and/or follow-ups completed in this period include 22 inspections at various locations. During this period the Boiler and Machinery carrier reported 66 new code violations of which 14 were have been complied with. The Boiler and Machinery carrier noted agency compliance with six previously issued code violations. Loss Prevention follows up with the agency until violations are cleared and risk improvement actions are implemented. When the violations are actually completed the Certificate is processed.

*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](http://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.*