



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

December 13, 2011

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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 6, 2011. I invite and welcome further discussion with the Committee at your convenience.

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

While the State’s fiscal picture seems to be improving slightly due to the strength and diversity of Maryland’s economy, the State continues to face fiscal challenges. The Office’s experienced staff continues to assist State agencies in many ways including expanding the use of innovative banking services such as remote deposit, negotiating reduced insurance premiums while enhancing coverage, and advising on procurements.

We 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 School Construction Bonds, Qualified Zone Academy Bonds and Qualified Energy Conservation Bonds. Lastly, we continue to invest State funds prudently and conservatively to minimize risk to the Maryland taxpayers.

While we continue to do more with less, the Office is implementing improvements and achieving real results. The items set forth below detail a number of these achievements and we are always available to provide greater information or answer questions regarding these and other issues.

BOARD OF PUBLIC WORKS

Between June 1, 2011 and November 30, 2011, the Board of Public Works (BPW) met 11 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:

Energy Performance Contracts & Related Financing

- Approval of a 13.5 year energy performance contract award to Pepco Energy Services for energy conservation measures at MD Port Administration facilities, including the World Trade Center, with a guaranteed energy savings of \$28.7 million over the life of the contract. (7/6/11)
- Approval of the financing of approximately \$10.8 million acquisition of certain energy systems, equipment and related facility energy improvements related to the 13.5 year energy performance contract referenced above. Annual guaranteed savings will exceed annual debt service; therefore the amount of debt does not count in capital debt affordability calculations. The balance remaining on authorized energy lease financing after this item is \$89.2 million. (11/2/11)

Public School Construction

- I. **Charles County - St. Charles High School:** \$6.86 million was released from a contingency fund for use by Charles County as this project was placed under contract for construction by the September 1st deadline imposed by the BPW. (10/19/11)
- II. **Supplementary Appropriation - Alcoholic Beverages Tax Increase:** During the 2011 Legislative Session, legislation (HB 1213/Chapter 572) was passed to increase the tax on alcoholic beverages from 6% to 9%. The bill requires a **supplementary appropriation of \$47.5 million** in FY 12 for public school construction projects in local jurisdictions. The BPW is required to approve the individual projects for each local jurisdiction based upon criteria set forth in the legislation. The following requests were approved:
 - **Anne Arundel County: \$5 million** for the design, construction, furnishing and equipping of an addition to Annapolis High School to support a Performing and Visual Arts Magnet program. (10/5/11)
 - **Baltimore County: \$7 million** for eight projects at Woodlawn High School, Glyndon Elementary School, Randallstown Elementary School, Chatsworth Elementary School, Cedarmere Elementary School, Pikesville Middle School (two projects) and Franklin High School. (10/19/11)

- **Howard County: \$4 million** for five projects at Atholton High School, Hammond High School, Oakland Mills High School, Wilde Lake High School and Wilde Lake Middle School. (10/5/11)
- **Montgomery County: \$9 million** for four projects at Cabin John Middle School, Cannon Road Elementary School, Farmland Elementary School, and Garrett Park Elementary School. (10/5/11)
- **Northeast Region: \$1.25 million** for Cecil and Harford Counties. The two counties reached agreement that the funds should be allocated two-thirds to Harford County (\$833,750) and one-third to Cecil County (\$416,250) based on facilities and enrollment data. (11/16/11)
 - **Harford County: \$833,750** for two projects at Havre de Grace Elementary School and Church Creek Elementary School.
 - **Cecil County: \$416,250** for five projects at North East High School (two projects), Elkton Middle School, Cecil Manor Elementary School, and North East Middle School.

Facilities and Services of State Agencies

- A tenant lease between the Department of Health and Mental Hygiene and MEDCO was approved that will facilitate the sale of MEDCO tax-exempt bonds to fund MEDCO's construction of a **Public Health Lab** to be located in East Baltimore as part of the Science and Technology Park at Johns Hopkins. (8/10/11)
- Approval of a contract to provide comprehensive **call center/help desk** services for **University of Maryland, University College** in a call center located in Largo. The contract will bring 150-200 jobs to Prince George's County and will provide a marketing tool for student attraction and retention at UMUC. (9/21/11)
- Approval of a long-term lease (90 years) between Montgomery College and **Holy Cross Hospital** to allow a 93-bed health care facility to be built on land owned by the College in the Montgomery County Science and Technology Park in Germantown. (6/15/11)
- Approval was given for six month extensions for **Prisoner Health Care** of four health care contracts for inmate health services to allow time for a replacement contract award, including transition periods, for:
 - Medical Care services contract with Correctional Medical Services, Inc. (CMS).
 - Mental Health Services contract with MHM Correctional Service of MD, Inc.
 - Utilization Management Services contract with Wexford Health Sources, Inc.
 - Pharmacy Program contract with Correct Rx Pharmacy Services. (6/1/11)

Information Technology

- Approval of a contract to provide enterprise-wide **eGovernment services** that are available for all State agencies, boards and commission, thus providing an enhanced web-based electronic procurement system for the State. (8/10/11)

- Approval of a contract to provide Google-based **cloud messaging** and collaboration services so that State email users may be consolidated into a single platform for electronic messaging services and collaborative tools and support. DHMH will be the first agency to use this new contract, using federal funds to cover costs. Other agencies will purchase their subscriptions to the cloud email services as funding becomes available. (9/21/11)
- **One Maryland Broadband Project:**
 - Approval of a Master Contract for purchasing, installing, maintaining and servicing fiber optic cable throughout the State in furtherance of the \$158 million effort to provide broadband throughout the State. (10/19/11)
 - Approval of a single permit wetlands license for the installation of fiber optic cable at 20 specifically identified locations throughout the State as a part of the One Maryland Broadband Project. (11/16/11)

BWI Thurgood Marshall Airport (BWI)

- Approval of a \$10 million contract for construction and improvements at BWI to facilitate the merger between Southwest and AirTran Airlines. Improvements will include a new security checkpoint at lower level Concourse A to add screening capacity and efficiency and to increase the throughput of passengers through security and an expansion of the existing terminal between Concourses B and C creating a continuous airside connector for Concourses A, B and C. (8/10/11)
- Approval of three separate contracts or contract modifications designed to increase passenger traffic at BWI:
 - Marketing, advertising and communications services contract designed to increase international air service from BWI.
 - Contract for the development of a comprehensive strategy to ensure BWI reaches its fullest potential as an international and domestic gateway airport.
 - Customer survey services are procured in order to assess and improve the quality of service provided to passengers.
- Consideration of a five-year contract to operate the taxi franchise at BWI, with final action being to reject the new contract, extend the current contract for another year and require the MD Department of Transportation, MD Aviation Administration to rebid the contract taking into account job security for drivers, the treatment of drivers, and the state in which bidding companies are located. (6/15/11)
- Approval of contracts to provide shuttle bus/van service for BWI patrons between the Airport Terminal Building, public parking facilities and the BWI Rail Station Parking Facility. (6/1/11)
 - Two year renewal option of contract with First Transit to operate the shuttle bus/van service at BWI.
 - Two year extension of contract with First Transit for their leasing of 50 buses to provide shuttle service.
 - Two year extension of agreement to lease land to First Transit for shuttle bus office, operations center and shuttle bus parking.

Personnel – Rule of 100

- Creation of three positions in DHMH to support the **Maryland Health Benefit Exchange**. Federal funding is provided to cover start-up costs of the Exchange, including these positions. At a later date, the costs of these positions will be supported with Exchange fee collections.
- Creation of one position in the Office of the Attorney General to support the **Maryland Health Benefit Exchange**. This position is paid for from federal funds and, at a later date, will be supported by Exchange fee collections. (9/21/11)
- Creation of three positions outside of the “Rule of 100” at DHMH for the **Prescription Drug Monitoring Program**. Funding comes from Bureau of Justice Assistance funding. (10/19/11)
- Creation of four positions outside of the “Rule of 100” at DHMH to staff an effort to **reduce youth access to tobacco products**. Funding for these positions comes from a federal grant that DHMH received to reduce youth access to tobacco products in Maryland. (10/19/11)
- Creation of 17 positions outside of the “Rule of 100” at the **Department of Natural Resources** to perform certain essential DNR-core functions. The positions were previously contractual positions and will be converted to full-time positions with funding coming from federal and non-State sources. (6/15/11)

INVESTMENT DIVISION

Once again, the Treasurer’s conservative investment policy and practices have protected the portfolio through these continued volatile and unprecedented economic times. One recent example: MF Global, a Prime Brokerage Firm, was downgraded October 24, 2011 and downgraded again on October 27. The Investment Division immediately cancelled all outstanding Repurchase Agreements with them and received all principal and interest earned to date on October 28. The firm declared bankruptcy on October 31. Not all their counterparties received their money back, as there is \$1.2 billion reported missing by Bloomberg News. Due to the policies and procedures in place, the Investment Division not only recognized the impending situation, but was able to respond quickly. The par value of the General Fund Investment Portfolio for November 30, 2011 was \$5,083,883,015 as compared to November 30, 2010 when it was \$5,295,224,247. This is a decrease of over \$211 million.

On November 30, 2011, the portfolio was earning an average of .838%, compared to 1.538% for the same date in 2010. The return reflects the impact of the Federal Open Market Committee maintaining the Fed Funds Target rate at .25% or less since December 16, 2008. For comparison, the three month constant maturity Treasury Bill averaged .02% since July 2011 as compared with .15% 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 FY 2012 are \$19,997,795 as compared with \$18,297,180 received for the same time period in FY 2011. This is a \$1.7 million increase in interest received.

The following chart tracks the impact of the legislation passed in FY 2010 to reduce the number of individual agency accounts that receive an interest allocation from the total interest earned on the investment portfolio. As you can see, the General Fund continues to receive less than 50% of interest earned.

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 | 53,002,765 | 87,698,955 | 140,701,720 | 62% |
| AS OF NOV FY2012 | 19,997,795 | 23,056,975 | 43,054,770 | 53% |

The Securities Lending Program continues to provide additional revenue. The program has earned \$170,559.49 so far in FY 2012. This compares with \$94,579.49 for the same period in FY 2010. The almost doubling of the revenue, although good for the State, signifies the decrease in liquidity in the financial markets, one of the economic indicators the Investment Division monitors closely.

The Office continues to increase MBE participation in the investment of State funds. Twenty MBE broker/dealers are on the Office's approved list for FY 2012 and they have handled investments of over \$287 million so far this fiscal year. This compares to FY 2010, when the Office had 19 approved broker/dealers who handled over \$429 million in investments by the end of November. The Office has invested almost half a billion dollars less year-to-date.

The Maryland Local Government Investment Pool (MLGIP) AAAM rating was reaffirmed by Standard and Poor's on September 26, 2011. The pool balance at November 30, 2011 was \$3,583,584,740 compared with \$3,392,991,687 for the same date in 2010. This is an increase of \$190 million dollars due to the lack of safe short term investment alternatives for Investment Pool members at a comparable yield. The MLGIP is paying .09% as of November 30, 2011 as compared with .19% last year. The MLGIP is in total compliance with the new Money Market rules and regulations and received a clean audit from McGladrey & Pullen, LLP.

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

BANKING SERVICES DIVISION

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

The Division is directly responsible for managing the banking services needed for all agencies of the State. Over the past six months, the BSD was directly involved in the awarding of three major contracts for statewide financial services:

- **Lockbox Banking Services** – provides lockbox services associated with the receipt and deposit of payments made to over 33 different State agencies. The procurement resulted in the selection of a new vendor, Citibank, N.A., to provide the State with critical financial services. The Division continues to work closely with Citibank on the transition of these services away from the current lockbox provider, SunTrust Bank. The initial implementation has targeted three major lockbox using agencies representing over 50% of total statewide lockbox transaction volume. Citibank's state of the art, real-time processing capabilities are expected to result in a number of significant efficiency enhancements for these agencies.
- **General, Income Tax Refund, and Payroll Disbursement Services** – the procurement selected a financial institution to provide general, income tax refund and payroll disbursement services for the State of Maryland. The procurement resulted in the reappointment of the incumbent service provider, M&T Bank.
- **Depository Banking Services** – this procurement selected a financial institution to provide depository banking services for all agencies of the State that are required to deposit receipts directly into the State Treasury. The procurement also

resulted in the reappointment of the incumbent service provider, Bank of America, N.A.

Banking Services 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 Division 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 the Treasurer's Office to be proactive in identifying and solving 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 completely documented reconciliation of the State's cash accounts. For FY 2011, total cash receipts and disbursements each exceeded \$180 billion and the State's bank accounts continued to be reconciled to the penny on a daily basis to the State's general ledger.

In addition to the above mentioned reconciliation duties, the Division 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 as well as requests for photocopies of paid checks
- Initiating replacement checks for failed ACH payments
- 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 worked with the Department of Information Technology on the initial implementation phase of a procurement to provide self-funded eGovernment applications and services support for the State of Maryland through a centralized web portal. Banking Services assisted several of the State's local health departments in the implementation of merchant card accounts for the processing of fee collection and also assisted the Governors Grant's Office with the implementation of on-line collection of registration fees for the Governor's Grants Conference.

Another responsibility of the Division is to ensure protection of all State funds on deposit with financial institutions through monitoring of bank account and collateral balances. Banking Services Division has continued to work closely with the Information Technology Division in making additional enhancements to the Treasurer's Bank Account Information System (TBAIS) which went live in January of 2011. To date, applications to open over 100 agency bank accounts have been submitted by various State agencies using the new on-line electronic X-1 application form. Turnaround time for the approval of these critical accounts has been significantly improved over the prior

paper based process. In November, a TBAIS related training session was conducted for the Maryland Judiciary's Circuit and District Court finance personnel.

Banking Services 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 Division will continue to explore new financial products and improved data delivery methods that will increase its capabilities to provide efficient, cost-saving, banking services to Maryland State agencies.

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 and tunnels, the Baltimore Washington International Thurgood Marshall Airport and the Port, rail operations, assorted professional liability exposures and student athlete accidents. The State also self-insures a significant portion of its exposures and maintains the State Insurance Trust Fund to pay claims and the costs associated with handling those claims. Self-insurance coverage includes State-owned real and personal property, vehicles, and liability claims covered under the Maryland Tort Claims Act.

The Insurance Division is comprised of four Units: Underwriting, Claims, Tort Litigation Management and Loss Prevention. The Division's goal is to provide statewide risk management through loss protection (Underwriting), loss restoration (Claims and Tort Litigation Management), and loss control (Loss Prevention).

State Outreach

Over 130 State employees attended the Insurance Division's workshop held on November 2, 3, and 4. The 2-1/2 hour workshop was designed to educate State personnel on the State Insurance Program and its benefits.

The Division's management team, led by Director, Laura C. McWeeney, presented an overview of the functions that make up the "three-legged stool" of the Insurance program: Underwriting, Claims and Litigation, and Loss Control. The Division's managers provided information on how agencies could take advantage of the benefits and services each unit offered. Other workshop presenters included representatives from the State Accident Management vendor, PHH, and the State's Boiler and Machinery insurer, Zurich Insurance.

Feedback from the participants on the workshop's content and presenters was overwhelmingly positive. Many participants requested that the Division hold workshops more frequently. Some participants requested customized workshops for their agencies

with a focus on areas of particular interest. In response to the participants' feedback, plans are underway for the Division to design and implement "mini" workshops focused on how to manage catastrophic losses and how to develop personalized loss control programs.

Underwriting

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

The Maryland Aviation Administration (MAA) airport liability renewal, effective August 15, 2011, for Baltimore Washington International Thurgood Marshall (BWI) and Martin Airports was profitable this year. BWI continues to grow yet, their losses remain very low. Our insurance carrier reduced the expiring premium of \$372,171 to \$290,003 with no reduction in coverage. This represents a **savings to MAA of \$82,168**. The insurance carrier also offered a plan that may return some premium to MAA after expiration if the losses remain low.

The Maryland Port Administration (MPA) has a policy for its cranes that renewed on November 25, 2011. We renewed with Ace American Insurance Company which offered an 8% rate reduction although crane values had increased by 3%. **The improved coverage and deductible saved MPA \$7,809.**

The Treasurer's Office buys three separate terrorism policies. One is for State-owned buildings and contents. Another provides increased limits of coverage on our bridges and tunnels, and the third, provides a small amount of chemical, biological, nuclear, and radiological coverage. In today's market, despite terrorist events around the world, we renewed all three policies with no increase in premium. Our purchased policy offers the broadest coverage available in the market.

The Maryland Transportation Authority (MdTA) has a liability policy for its toll bridges and tunnels. The October 17, 2011 renewal exposures were up as we added the new Inter County Connector (ICC) which is opening in phases from 2011 to 2014. MdTA determined that they could afford an increased deductible, so we **renewed with a deductible increase from \$3,000,000 to \$5,000,000, broadened coverage and saved MdTA \$45,076.**

Accident insurance for our college NCAA athletes renewed August 1, 2011. This year all of the schools were offered a "fully insured" quote as expiring, with alternate deductible options. We renewed with a nationally known expert in the field of intercollegiate sports, QBE Insurance Corporation (QBE). Service is a paramount concern for the schools and we had received numerous recommendations from other large schools like Virginia Commonwealth University, San Diego State University, and the University of Nevada, Las Vegas, about service that would accompany the QBE quote. The expiring premium was \$462,725. The incumbent's renewal quote was

\$731,105 which was an increase of \$268,380. We changed carriers and renewed with QBE with a premium of \$506,333, which is an increase of only \$43,608, saving the schools \$224,772.

The schools were also offered our first webinar to inform them about the new claim forms, procedures, and contact names and numbers before the coverage became effective. The webinar also gave the schools the opportunity to pose questions to the new broker and insurance service provider. The schools expressed very positive feedback on the renewal options offered and the new carrier and service provider selected.

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.

State Catastrophe response

On August 23, 2011, a 5.8 magnitude earthquake, centered in an area northwest of Richmond, Virginia, shook Maryland and affected several State-owned properties, including many in the Annapolis Complex.

Within hours, the Claims Unit alerted the State's commercial carrier and began its outreach to affected State agencies. The commercial carrier and the Claims Unit soon began planning the deployment of structural engineers and other claims experts to begin the painstaking task of analyzing all of the damaged structures reported by State agencies.

But, before the Claims Unit could begin assessing the damage caused by the earthquake, the National Weather Service sent an alert which predicted that Hurricane Irene would strike just days later. Prior to Irene's arrival, the Treasurer's website was updated with vital information for State agency personnel which included the Insurance Division's emergency contact number, tips on how agencies could prepare for the storm, steps State personnel could take to mitigate further property damage after the storm, and helpful links to other websites such as the Maryland Emergency Management Agency.

On August 27, 2011, Irene pounded Maryland's Eastern Shore and her affects were felt as far west as Frederick. Several State-owned properties were flooded, structures and walkways in State parks were washed away, and high winds caused power outages at several State university campuses which caused delays for hundreds of new and returning students.

The Claims Unit and the commercial carrier leapt into action following the two events. Their task of assessing the State's damage caused by both events, as well as isolated areas of damage caused by Tropical Storm Lee, continues. The State is self-

insured for the first \$2.5 million of damage, per occurrence. The commercial insurance covers damage in excess of \$2.5 million, per occurrence. The entire scope of damages caused by these events is expected to be determined by early 2012.

Tort Litigation Management

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

In FY 2011, the Litigation Manager began tracking the reason for or actual method of disposition of all cases closed since July 1, 2010. The Tort Unit handles a rolling docket of 120 suits at any one point in time. The disposition reason or method of each case disposed of as of November 18, 2011 is noted in the following table:

| Disposition | Reason or Method | Count |
|--|---------------------------------|-----------|
| Dismissal | Motions granted | 39 |
| | Notice of claim not provided | 1 |
| | State not served | 0 |
| | Non – State | 2 |
| | Voluntary w/o prejudice | 5 |
| | Voluntary w/prejudice | 6 |
| Verdict | Adverse | 6 |
| | State | 9 |
| Settlement | Pre trial settlement | 15 |
| | Pre trial settlement conference | 11 |
| | Mediation | 5 |
| | Settlement at trial | 0 |
| | Post trial settlement | 0 |
| TOTAL CASES CLOSED SINCE JULY 1, 2010 | | 99 |

Loss Prevention

An historical valuation of Davidge Hall, located at the University of Maryland, School of Medicine was completed in November 2011. The facility is recognized as the oldest medical facility in the country in continuous use for medical education.

In November 2011, initial and recertification in Fatigue Management training began for approximately 100 pilots, medics, and maintenance technicians involved in the 24/7, 365 day a year multi-mission flight operation of the Maryland State Police Aviation

Command (MSPAC). This program was arranged by the Loss Prevention Manager in conjunction with our insurance broker, and addresses one of the safety recommendations made by the National Transportation Safety Board following the tragic crash on September 27, 2008, involving Trooper II.

The Electrical Infrared Testing program was completed in September 2011. These inspections provide valuable information on the condition of equipment in State agency facilities. Thermographic imaging 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. Reports and findings were forwarded to all participating agencies for comment and/or corrective action.

In November 2011, University of Maryland Baltimore County participated in the Aerial Infrared Testing program. The University was selected due to recent storm related property damage losses to roofing structures within the last year. The purpose of testing is to identify the location of moisture penetration of roofing systems before there are visible signs, structural damage or business interruption. With the results of this analysis, State agencies and universities can significantly extend the life of roofing structures while reducing maintenance expenditures and potential property-related claims.

The Maryland Transit Administration (MTA) participated in the property loss control inspection program. The inspection of various premises included the large bus operations facility, administrative offices, training and bus repair facility, as well as the rail and bus communication areas. The survey entailed identification and evaluation of potential risk and liabilities for loss of property and business interruption through fire, theft, and other perils. Reports of the inspection and risk improvement recommendations were forwarded to MTA for comment and corrective action.

INFORMATION TECHNOLOGY DIVISION

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

The IT Division continued to bring numerous enhancements to the Treasurer's Bank Account Information System (TBAIS). This system co-developed by the Banking Services Division (BSD) and the IT Division replaced the BAIS system hosted by the Comptroller's General Accounting Division (GAD). These enhancements included: conversion programs that loaded collateral and interest data obtained by Banking Services via agency surveys, screen modifications that allow updates to collateral and interest data, and the ability to add notes to existing bank accounts. New utility programs were also developed to globally change the Bank Identification in Account Master Records when a bank merger occurs. Additional programming is currently in progress

and will bring new functionality to bank collateral and account interest reporting and tracking.

The IT Division's Network Services staff continued their support of all network, firewall, application servers and PC hardware. They also handle all custom software utilized within the agency, including, but not limited to, Mun-ease, Sungard, LAS (Leave Accounting System), M&T Check Viewer, Matter Tracker, PTX Viewer, Rumba, J-Walk, NGS Query, Orgplus and the entire MS Office Suite including MS Project. Recent accomplishments by Office's Network Service include: installation of new battery backup hardware to improve power protection, reliability, and uptime of core network equipment; the launch of new scanner hardware and software to support the new streamlined paperless process for General Accounting Division's batch submittal; support for July and September bond sales including updates to BuyMarylandBonds.com; and continued our rollout of new PC hardware and Office 2007.

Disaster Recovery (DR) planning is an important responsibility to the State Treasurer's IT Division. In February of this year, the Division executed a Disaster Recovery test at our DR vendor's office. The test was a great success due to weeks of planning and organization. This test, like many in the past, always results in new ideas and methods to better prepare the Office for an actual contingency.

The Information Technology Division worked with the Investment Division to design, test and implement a completely new Interest Allocation System in record time. The application receives automated fund balance updates each day from the R*STARS system. The new system allows the Division to update agency account information, default account information, daily balances for new accounts, and interest and management rates used for monthly report calculations. The system automatically creates transactions in a monthly Investment Transaction File that after review, is sent to, and posted on R*STARS. The new Interest Allocation System significantly reduces client data entry and includes a feature to export all of the reporting to an Excel spreadsheet. The spreadsheet is then used for internal documentation and agency research requests. The new system permits the Investment Division to now run the allocation process days earlier than in the past, with greater efficiency and significantly reduced margin for error.

DEBT MANAGEMENT DIVISION

Ratings

Maryland is one of eight states with AAA ratings from all three rating agencies. The states are Maryland, Delaware, Virginia, North Carolina, Georgia, Missouri, Iowa and Utah. However, Moody's has recently changed the outlook from stable to negative on the State's General Obligation Bonds due to concerns regarding the federal government.

On July 13, 2011 and in early September 2011, Moody's Investors Service, Standard & Poor's (S&P) and Fitch Ratings all affirmed the State's AAA rating. (See below for excerpts from the July ratings reports). Moody's, however, placed the General Obligation Bonds of Maryland (and four other states, including Virginia) on negative outlook after the August 2, 2011 assignment of a negative outlook to U.S. government debt. S&P has also expressed concern about the effect of federal budget reductions on Maryland's credit. In its September 7 rating report S&P stated, "Downside risk for the rating includes our view of the potential for significant reductions in federal funding that currently flows to the State. Standard & Poor's will continue to monitor the federal consolidation efforts stemming from the Budget Control Act and, once these are identified, will evaluate their effect on Maryland's finances and the State's response to these revenue reductions."

As of the date of this report, there have been no further rating actions although Moody's has requested confirmation of certain financial indicators that measure the reliance of the State on federal employment, procurement, and Medicaid.

Meetings with Rating Agencies

Prior to the confirmation of the State's AAA rating, analysts from Fitch Ratings, Standard & Poor's and Moody's Investors Service visited Annapolis on Wednesday, June 29 and Thursday, June 30 to attend meetings prior to rating the 2011 Second Series General Obligation Bonds. The State Treasurer's Office extended this invitation to the rating agencies to highlight the progress made in the 2011 Legislative Session on the structural deficit and pension sustainability. Typically the rating agencies review the State's credit by telephone prior to each sale but periodically a personal visit such as this one is scheduled.

Working sessions included presentations on the Economy and Revenues, Video Lottery Terminals, Budget, Pension and Retiree Health Reforms, Legislative Updates and Debt Issuance plans. To demonstrate the positive impact of BRAC on the Maryland economy, the rating agencies toured Ft. Meade and surrounding areas on June 30.

Participating in the meetings were the Treasurer, Comptroller, Secretary of Budget and Management, Director of the Bureau of Revenue Estimates, Executive Director of the Maryland State Retirement Agency, and the Director of Policy Analysis for the General Assembly and staff. Representatives from the Legislature were also in attendance. The Lieutenant Governor and his staff led the visit to the BRAC facilities at Ft. Meade.

Excerpts from Ratings Reports

Generally, there is consensus among the rating agencies in evaluating the State's credit strengths and weaknesses. The following summarizes the most recent reports:

Fitch Ratings, in assigning the AAA rating and stable outlook, noted:

- *Debt oversight is strong and centralized, and the debt burden is moderate. The State has policies to maintain debt affordability, and the constitution requires GO and transportation bonds to amortize within 15 years.*
- *Pension funding levels have deteriorated, although the State is undertaking extensive pension and other post-employment benefit (OPEB) reforms.*
- *The State has a diverse, wealthy economy, benefiting from its proximity to the nation's capital.*
- *Financial operations are conservative, and the State maintains a Rainy Day Fund to manage revenue cyclicity. 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.*

Credit challenges that were cited by Moody's include:

- *Continuing budget pressure*
- *Low retirement system funded levels*
- *Above average debt burden (S&P and Fitch consider the debt burden moderate.)*
- *Reliance on federal jobs in year of retrenchment*

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 Financing - General Obligation Bonds

Since our last report, the State has had two Bond Sales. The 2011 Second Series A, B, C and D totaled \$512,400,000 and the proceeds were used to finance new projects. It closed on August 5, 2011 and had four series:

Series A - \$71.7 million in Tax-Exempt Bonds sold in a negotiated sale with first priority to Maryland citizens

Series B - \$418.3 million in Tax-Exempt Bonds sold in a competitive sale primarily to institutions

Series C - \$15.9 million of Qualified Zone Academy Bonds (QZABs)

Series D - \$6.5 million of Qualified Energy Conservation Bonds (QECBs)

The QZABs and QECBs were taxable bonds with, respectively, 100% and 70% direct interest subsidies from the US Treasury, respectively. Net of the federal subsidy, the TICs (True Interest Costs) were .07% for the QZABs and .62% for the QECBs and the State realized more than \$8 million in present value savings by issuing these bonds instead of traditional tax exempt bonds.

On September 28, 2011 the State issued \$254,915,000 (2011 Second Series E) to advance refund certain outstanding General Obligation Bonds. As a result of the refunding, a net present value debt service savings of approximately \$11.1 million was realized.

Closed Financing – Leases

The Capital Lease-Financing Program allows State agencies to acquire equipment and pay for those items over a three, five, or ten year time frame. Between May 16, 2011 and November 15, 2011, \$.9 million in capital equipment (primarily IT equipment) was leased by State agencies through the State Treasurer's Office.

The Treasurer's Office also finances Energy Performance Leases in cooperation with the Department of General Services (DGS), providing funding for energy conservation at State facilities. The program finances significant up-front investments in conservation projects; the lease is paid using the savings in operating costs. No energy leases were financed between May 16, 2011 and November 15, 2011.

2012 Financing Plans

The next General Obligation Tax-Exempt financing of approximately \$465 million is planned for early March 2012. The State Treasurer's Office expects to again offer a retail component of the tax-exempt bonds with first priority to Maryland citizens.

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.

The Treasurer's Office encourages legislators and all interested persons to attend the pricing calls for the negotiated sales which are tentatively scheduled for March 2 and March 5, 2012 and/or the competitive sale on March 7. Please contact the State Treasurer's Office for the locations and times if you are interested.

Status of the Annuity Bond Fund

Debt service on General Obligation Bonds is paid from the Annuity Bond Fund (ABF) and the primary source of revenue for this fund is real property tax receipts. The Capital Debt Affordability Committee's 2011 Report updated projections for the Annuity Bond Fund after the issuance of the 2012 Second Series Bonds. A General Fund subsidy is projected for fiscal years 2013 through 2016 if the tax rate is not changed and other assumptions, including no bond premiums, remain as currently projected. Please refer to pages 15 and 16 in the 2011 CDAC report for projections. The report is available on the Treasurer's website at <http://www.treasurer.state.md.us/debtmanagement/cdac-reports.aspx>

Capital Debt Affordability Committee (CDAC)

General Obligation Recommendation

At the September 21 meeting, the Committee unanimously recommended a \$925.0 million limit for new General Obligation authorizations by the 2012 General Assembly to support the 2013 capital program. The Committee's projections for future authorizations assume generally level authorizations through 2016 of between \$925.0 million and \$955.0 million. In 2017 the projected authorization is \$1,200.0 million and it increases by approximately 3% through 2021.

With these authorization levels, the debt affordability ratios remain within the CDAC benchmarks of 4% debt outstanding to personal income and 8% debt service to revenues. The affordability analysis presented at the September 21 meeting indicates that the Committee's projection of General Obligation Bond authorizations is currently affordable. The personal income criterion peaks at 3.47% in fiscal year 2013 and is at 2.92% in fiscal year 2021. The debt service criterion increases annually to 7.72% in fiscal year 2017 but declines to 7.05% in fiscal year 2021.

The motion to recommend \$925.0 million specifically recognized that authorization levels proposed in the Governor's 2013 Capital Budget could be adjusted to reflect up-to-date economic and fiscal information and the Board of Revenue Estimate's December revenue estimates. Accordingly, the Capital Debt Affordability Committee may review its authorization in December 2011 and make any necessary modifications to its recommendation.

Evaluation of the Capacity to Increase Academic Revenue Bonds Issued by the University System by \$5 million and the CDAC Recommendation for Academic Facilities Bonds

As required by Chapter 396 of the 2011 Laws of Maryland, CDAC evaluated the capacity of the University System of Maryland (USM) to increase the amount of Academic Revenue Bonds (ARBs) by \$5.0 million. USM has reported that the total debt planned for 2013 will not change; only the allocation between academic and auxiliary bonds will change. CDAC concluded that the overall level of debt is prudent over time and accepted the breakdown between academic and auxiliary as proposed by the system. Based on its review of the condition of State debt in light of the debt affordability guidelines, the Committee therefore, recommended a limit of \$32.0 million for new academic facilities bonds for the University System of Maryland for fiscal year 2013, an increase of \$5.0 million from last year's recommendation of \$27.0 million. The Committee did not receive any requests for new issuances for Morgan State University, St. Mary's College of Maryland and Baltimore City Community College and therefore made no recommendations for these institutions.

Miscellaneous CDAC Reviews

There were also miscellaneous reviews conducted by CDAC in 2011 which included an evaluation of the debt affordability process, the impact of Public-private Partnerships and the inclusion of energy leases in the debt affordability analysis. A summary of these reviews follows.

The legislative budget committees requested CDAC to evaluate the State's debt affordability process and make recommendations for consideration by the General Assembly in the 2012 Session. This evaluation and recommendations are in Section VII in the CDAC Report.

Chapter 641 of the Laws of 2010, codified at SF&P §10A-102(d), requires the Committee to analyze and report on the aggregate impact of Public-private Partnership agreements on the total amount of new State debt that prudently may be authorized for the next fiscal year. There were no Public-private Partnerships presented to CDAC during this reporting period. In 2010 the Committee concluded that the proposed State Center Public-private Partnership would have no impact on the total amount of new State debt that may be authorized because the lease approved by the Board of Public Works on July 28, 2010 met the criteria for operating leases. However, on the advice of the State's external auditor in 2010, the final determination of the classification of the occupancy leases at State Center should be done at the time the State actually occupies the space. A review of Public-private Partnerships is included in the Section II. D in the CDAC Report.

In accordance with SF&P §8-104(c), leases are considered tax-supported debt when the lease or unit of State government is "supported directly or indirectly by State tax revenues". However, SF&P §8-104 was amended in the 2011 Session by Chapter 163 of the 2011 Laws of Maryland. Effective June 1, 2011, tax supported debt does not include capital leases used to finance energy performance contracts if, as determined by the CDAC, energy savings that are guaranteed by the contractor:

- (i) equal or exceed the capital lease payments on an annual basis; and
- (ii) are monitored in accordance with reporting requirements adopted by the CDAC.

Section II. D in the Report describes the guidelines adopted by CDAC to determine if a capital lease should be considered in the affordability analysis and summarizes the leases that are and are not included in the affordability analysis.

The 2011 Capital Debt Affordability Report and the 2011 meeting materials are available on the State Treasurer's website at

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

As noted in the opening section of this Report, present revenue and market conditions continue to impact the operations and achievements of the State Treasurer's Office in many ways. The Treasurer appreciates the opportunity to provide this report to the Legislative Policy Committee on a regular schedule. A copy of this report is also available on the State Treasurer's website: www.treasurer.state.md.us. If the

Committee or its members would care to pursue further these or other STO developments, or any other aspects of the Treasurer's activities, please call the Treasurer at (410) 260-7160 or Chief Deputy Treasurer Bernadette T. Benik at (410) 260-7390.