



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

December 17, 2013

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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, 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 June 1, 2013 and November 30, 2013, the Board of Public Works (BPW) met ten times to consider State procurements, expenditures of capital appropriations, the acquisition, use and transfer of State assets, issuances of licenses to dredge and fill wetlands, and the acquisition of land and easements in support of Program Open Space, the Conservation Reserve Enhancement Program, the Rural Legacy Program and the Agricultural Land Preservation Program.

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

Procurement

- Approved publishing for comment in the *Maryland Register* new regulations and amendments to existing COMAR provisions to implement legislation enacted during the 2012 or 2013 Legislative 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 and for American-manufactured goods (Chapters 559/560, Laws of 2012 and Chapters 437/438, Laws of 2013);
 - 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); and
 - Impose requirements for agency reporting on contracts with preferred providers. (Chapters 343/605, Laws of 2013) (10/2/13)

Personnel – Fiscal Year 2013

- **“Rule of 100”:** The fiscal year 2013 Budget enables the Board of Public Works to authorize the creation of up to 100 positions within the Executive Branch. During June 2013, the BPW:
 - Authorized the change of a part-time position (0.5 FTE) to a full-time position (1.0 FTE) at Maryland Department of Agriculture (MDA). The new position is needed to support the Agricultural Land Preservation Program (06/12/13); and

- Authorized the creation of 15 Special Fund positions within the Maryland Department of Transportation (MDOT):
 - 10 positions for MVA to implement the Maryland Highway Safety Act of 2013 (Chapter 309, Laws of 2013); and
 - 5 positions for the Maryland Aviation Administration (MAA) to maintain service for expanded facility operations and passenger growth at BWI Marshall Airport. (06/12/13)
- Authorized the creation of 24 federally-funded positions outside of the “Rule of 100” in the State Highway Administration (SHA). These 24 positions will be abolished when Federal Funds are no longer available. SHA is requesting these positions for the Maryland Coordinated Highway Action Response Team (CHART) focusing on reducing traffic congestion and improving safety.
- In fiscal year 2013, the BPW authorized the creation of 92.9 positions within the “Rule of 100” and 25 positions outside of the “Rule of 100”.

Personnel – Fiscal Year 2014

- **“Rule of 100”:** The fiscal year 2014 Budget enables the BPW to authorize the creation of up to 100 positions within the Executive Branch. Between June 1, 2013 and November 30, 2013, the BPW authorized the creation of 24.7 positions:
 - 10 Special Fund positions for Maryland Transportation Administration (MTA) to provide personnel for expanded MARC Train service on Saturdays and Sundays (8 positions) and to accommodate increased demand for MTA Commuter Bus Service in Southern Maryland (08/21/13);
 - 10 Pilot I positions within Maryland State Police to be used to provide two pilots at all time on the new AW 139 helicopters (09/18/13);
 - A 1.0 FTE position from a 0.8 FTE position in the Maryland Department of Labor, Licensing and Regulation, Division of Workforce Development and Adult Learning. A full-time teacher position is needed to instruct classes in a Correctional Occupation program. The increase in the number of hours with students will increase the number of students completing the program (09/18/13);
 - 2.5 positions for the State Board of Elections to develop and implement new enforcement procedures required by the Campaign Finance Reform Act of 2013 (Chapter 419, Laws of 2013), including the issuance of civil citations for certain violations of the State’s campaign finance laws (11/20/13); and

- 2.0 positions for the Office of the State Prosecutor to implement the provisions of the Campaign Finance Reform Act of 2013. The reform legislation will increase the number of election law civil citations issued by the State Board of Elections and the Office of the State Prosecutor, resulting in an increased workload for the Office of the State Prosecutor. (11/20/13)
- **New Positions Outside of the “Rule of 100”:** Approved a Department of Housing and Community Development (DHCD) request to establish 10 Special Fund positions outside of the 100 new position limitation contained in the fiscal year 2014 budget (“Rule of 100”). These requested positions would be abolished when the specific funding is no longer available. The positions will be supported with Special Funds received under the merger settlement between Exelon and the Constellation Energy Group, Inc. and will assist in the implementation of new energy efficiency initiatives at DHCD. (09/18/13)

Public School Construction

- Approved an amendment to fiscal year 2014 Capital Improvement Program to allocate \$18.123 million for air-conditioning initiative projects. \$25 million has been appropriated in fiscal year 2014 for this initiative. (09/04/13)
- Approved the Memorandum of Understanding that memorializes the agreement among the Maryland Stadium Authority, the Interagency Committee on School Construction, the Baltimore City Board of School Commissioners and the Mayor and City Council of Baltimore concerning the construction and revitalization of Baltimore City Public Schools. (Chapter 647, Laws of 2013) (10/16/13)

Public Safety

- Approved the request of the Department of Juvenile Services to modify its contract with the Silver Oak Academy to expand the capacity of the program from 48 male youth to 96 male youth. (06/12/13)
- Approved the issuance of a notice to proceed to complete Region 1, Central Maryland for the statewide Public Safety Wireless Communications System and authorized deployment, testing, and system acceptance on a county-by-county basis rather than a region-wide basis. Region 1 is estimated to cost \$47 million across multiple fiscal years. (07/03/13)
- Approved the Report of Emergency Procurement submitted by the Department of Public Safety and Correctional Services for a contract to upgrade the video recording systems at Baltimore Central Booking and Intake Center. (08/21/13)
- Approved the Report of Emergency Procurement submitted by the Department of Public Safety and Correctional Services for a contract to provide a system to prohibit cell phone use by inmates at Baltimore City Detention Center. (08/21/13)

- Approved the modification of an existing contract to provide for additional design services for the renovation of the existing Baltimore Pre-Release Unit (BPRU) and a portion of the adjacent Occupational Skills Training Center located in the Baltimore Correctional Complex to create a 60-bed Youth Detention Center facility for youth charged as adults. (09/18/13)

State Services and Facilities

- Approved the demolition of 9 buildings on 11 acres of the east campus of University of Maryland, College Park. (08/21/13)
- Approved modifications to the Charlotte Hall Veterans Home operation and management contract to include an electronic medical records system, information technology support and on-site pharmacy services. (08/21/13)
- Approved a request from the University of Maryland, Baltimore County (UMBC) to transfer to the UMBC Research Park Corporation, Inc. equity interests that UMBC initially acquired from incubator companies in its south campus facility and to authorize that equity interests from incubator companies in the future be vested directly in the UMBC Research Park Corporation, Inc. (10/16/13)
- Approved the modification of the Baltimore City Convention Center Operating Lease between the Mayor and City Council of Baltimore and the Maryland Stadium Authority to implement requirements of legislation enacted during the 2013 General Assembly Session (Chapter 283, Laws of 2013). The modifications include:
 - Extending the State's responsibility to contribute two-thirds of the Convention Center's annual operating deficit from December 31, 2014 through December 31, 2019;
 - Extending the State's responsibility to contribute \$200,000 annually to a capital improvement fund for the Convention Center from December 31, 2014 through December 31, 2019; and
 - Extending the State's joint leasehold interest in the Convention Center from December 31, 2014 through December 31, 2019. (10/16/13)

Land Conservation Programs

- Approved the expenditure of \$100,000 of Program Open Space funds for the acquisition in fee simple of 6 +/- acres located in Frederick County. The parcel is centered between Frostown and Turner's Gap, the scenes of intense fighting during the Battle of South Mountain on September 14, 1862. (07/03/13)
- Approved the expenditure of \$800,000 of Program Open Space funds for the acquisition of 603 +/- acres located in Worcester County known as The Furnace Tract

that will become part of Pocomoke State Forest. The property directly supports at least six rare, threatened, and endangered plant and animal species. (07/03/13)

- Approved the expenditure of \$525,000 of Program Open Space funds for the acquisition of a conservation easement to protect 221 +/- acres in Dorchester County. The conservation easement will preserve property along the Harriet Tubman Underground Railroad National Historical Park and Scenic Byway and will serve as the first Coastal Resilience Easement which will protect areas for wetlands to migrate as sea level rises. (08/21/13)
- The Rural Legacy Program is a program to preserve large blocks of contiguous open space that are among the State's most valuable due to myriad agricultural, forestry, natural and cultural resources. To protect these resources, the Rural Legacy Program, acting through local governments or private land trust sponsors, purchases conservation easements or fee simple interests in real property from willing land owners based on Rural Legacy Plans.

The BPW approved fiscal year 2014 funding for 15 Rural Legacy grants totaling \$13.512 million:

- Agricultural Security Corridor Rural Legacy Area (RLA): \$1.12 million (Caroline, Cecil, Dorchester, Kent and Talbot Counties)
- Anne Arundel South RLA: \$1.65 million (Anne Arundel County)
- Coastal Bays RLA: approved expansion to included 2,352 acres of farmland (Worcester County)
- Deer Creek RLA: \$1.456 million (Harford County)
- Dividing Creek RLA: \$1 million (Somerset and Worcester Counties)
- Huntersville RLA: approved expansion to include 553 acres (St. Mary's County)
- Little Pipe Creek RLA: \$650,000 and approved expansion to include one 32-acre scenic historic property. (Carroll County)
- Mattapany RLA: \$370,000 (St. Mary's County)
- Mid-Maryland Frederick RLA: \$1.731 million and approved expansion to include two properties totaling 246 acres. (Frederick County)
- Mid-Maryland Montgomery RLA: \$400,000 (Montgomery County)
- Mid-Maryland Washington RLA: \$1,245 million (Washington County)

- Mountain Ridge RLA: \$50,000 (Allegany County)
- Nanticoke RLA: \$1 million and approved expansion to include 4,100 acres around the Town of Vienna (Dorchester County)
- Patuxent-Prince George's RLA: \$1 million (Prince George's County)
- Piney Run RLA: \$960,000 (Baltimore County)
- Quantico RLA: \$560,000 (Wicomico County)
- Zekiah RLA: \$320,000 (Charles County) (08/21/13)

BWI Marshall Airport

- D/E Connector Project: This Project will provide additional gates and associated support facilities to meet existing and projected demand for international air service at BWI Marshall, especially in light of Southwest Airlines announced expansion of its international service. Work entails:
 - Consolidation of the existing passenger screening checkpoint at Concourses D and E into one 10-lane passenger security screening checkpoint;
 - Construction of the new D/E Connector with a sterile corridor to the international arrivals area in Concourse E; and
 - Repositioning two gates to service either domestic or international flights; and
- In support of this D/E Connector Project, the BPW took the following action:
 - Approved a contract modification to provide Program Management Services for the D/E Connector Program at BWI Marshall Airport. (07/24/13)
 - Determined that urgent circumstances require selection of contractors on an expedited basis and waived the Architectural and Engineering Selection Procedures in order to complete work on the D/E Connector Project by the winter of 2015, when Southwest will initiate international traffic. (07/24/13)
 - Approved the award of a contract to provide design and construction support services for the D/E Connector Project at BWI Marshall Airport. These services were procured with a waiver of the A/E selection process so as to expedite the selection process. (09/18/13)
- Approved a request by the Maryland Aviation Administration to use an Expedited Procurement Method to obtain the services of a contractor to provide overall facility maintenance at the Four Points Hotel at BWI Marshall Airport. The operator of the hotel, Sheraton, decided not to renew the lease. The hotel will close at the end of

November 2013. In order to preserve the integrity of the building while vacant, these building management services are required. (11/06/13)

Transportation

- Approved the modification of Maryland Transit Administration (MTA) contracts for Program Management Consultants and General Engineering Consultants to complete the design for the Baltimore Red Line transit project. (06/12/13)
- Approved the modification of MTA contracts for Program Management Consultants and General Engineering Consultants to complete the design for the Purple Line transit project. (07/03/13)
- Designated the Purple Line Light Rail Transit as a public-private partnership (P3) and approved the proposed competitive solicitation method for selecting a concessionaire for the Purple Line. (11/06/13)
- Approved a modification to the contract the State has with National Railroad Passenger Corporation (Amtrak) to expand existing MARC services to include weekend service on the Penn Line. (10/16/13)
- Authorized the sale by the MD Department of Transportation of Consolidated Transportation Bonds, Series 2013 (Second Issue) in an amount not exceeding \$300 million at a public sale to occur no later than December 31, 2013. (10/16/13)
- Approved the transfer of 490 acres (3 parcels of land) from the State Highway Administration to the Maryland National Capital Park and Planning Commission consistent with the Federal Highway Administration's Record of Decision on the Inter-County Connector (ICC). The property will be used for reforestation and wetlands remediation. The exchange is part of the environmental mitigation package that received upfront approval before the ICC was constructed. (11/06/13)

TREASURY MANAGEMENT DIVISION

During fiscal year 2013, the Treasurer created the Treasury Management Division 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 in electronic format.

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. Over the past six months, BSD continued to be actively involved in the conversion of lockbox processing to the new statewide lockbox provider; Citibank N.A. Forty-seven lockbox migrations have taken place. The implementation has been far more complex than anticipated, as many new features have been added to the lockbox processing, improving reconciliation processes at the State. This has not only involved transferring boxes from one provider to another; it has required total business process improvement at the agencies. The major accomplishment of the Lockbox Program during the last six months was that a new lockbox for Maryland Health Benefit Exchange (MHBE) was fully operational on October 1st, day one of the new healthcare program. Additional lockboxes for MHBE are being created and will be operational on the Federal “Go Live” dates for the additional services.

The Department procures financial products and services statewide. During the past six months, Banking Services conducted procurement on behalf of The Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans to provide banking services for all accounts under the control of the Board, including depository, controlled disbursements, and custodial services. The Department began the implementation process for the new Agency Depository Contracts for statewide banking depository services. Banking Services staff served on the evaluation committee for the Department of Human Resources, Child Support Enforcement Administration’s State Disbursement Unit.

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 each exceeded \$157 billion and 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 (which was complicated by the Federal Government Shutdown)
- Initiating Fed wire payments
- Managing foreign currency transactions
- Processing check stop payments, cancellations and reissues
- 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 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 will be upgraded and enhanced during the next six months 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 a Controlled Disbursement Account. It is anticipated that this account will provide for more efficient cash management for State vendor payments. This process went live December 1st, 2013. The next enhancement will be implementation of Payee Positive Pay Program for check disbursements. Payee Positive Pay will go live in spring 2014.

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 October 31, 2013 was \$648 million. The annual Bank Survey is being automated for security and efficiency. The survey is a verification tool to ensure all accounts are collateralized appropriately and monitored monthly.

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

Investment Department

The Treasurer's conservative investment policy and practices have protected the investment portfolio through these continued volatile and unprecedented economic times. It is a true accomplishment in this environment to report that all principal is intact and a modest but continuous return has been earned on the portfolio. The par value of the General Fund investment portfolio for October 31, 2013 was \$6,864,740,422.26 as compared to October 31, 2012 when it was \$6,450,878,782.93. This is an increase of \$413 million dollars.

On October 31, 2013 the portfolio was earning an average of 1.039%, compared to 0.836% for the same date in 2012. 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 0.03% from July 2013 until the end of October 2013 as compared with 0.10% 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 \$23,430,872 compared to \$17,489,065 received for the same time period in fiscal year 2013. The over \$5.9 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

Fiscal Year	Net General Fund	Allocated to State Agencies	Total	% of Total Allocated to State Agencies
2000	121,951,720	103,173,287	225,125,007	46%
2001	136,981,074	144,249,899	281,230,973	51%
2002	82,641,807	66,399,769	149,041,576	45%
2003	37,205,637	42,240,523	79,446,160	53%
2004	25,037,345	29,053,449	54,090,794	54%
2005	52,886,074	54,538,463	107,424,537	51%
2006	149,613,238	109,222,108	258,835,346	42%
2007	150,798,001	205,589,917	356,387,918	58%
2008	155,170,184	207,179,098	362,349,282	57%
2009	102,768,740	142,619,087	245,387,827	58%
2010	44,190,425	87,921,654	132,112,079	67%
2011	53,178,733	87,900,159	141,078,892	62%
2012	23,207,535	48,647,954	71,855,489	68%
2013	8,646,595	40,710,863	49,357,458	83%
Oct. 2014	5,868,354	17,562,517	23,430,871	75%

The Securities Lending Program continues to provide additional revenue. The program has earned \$85,935.98 so far in fiscal year 2014. This compares with \$152,763.26 for the same period in fiscal year 2013. The 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 \$60 million out of \$324 million so far this fiscal year. This compares with fiscal year 2012, when the Office had twenty-two approved MBE broker/dealers who handled \$259 million out of \$2,358 billion in investments by the end of October. In fiscal year 2013 over \$2 billion had been invested by October 31, 2013 while less than half a billion has been invested to date in fiscal year 2014. This was due to the shift in the interest rate environment immediately following Fed Chairman Bernanke's mention in June 2013 of tapering of the Fed's "quantitative easing" program. This announcement severely impacted the pace of calls of agency paper due to the rising interest rate environment.

The Maryland Local Government Investment Pool (MLGIP) AAAM rating was reaffirmed by Standard and Poor's on September 30, 2013. The Pool balance at October 31, 2013 was \$3,340,878,543.39 compared with \$3,130,690,299.89 for the same date in 2012. This is an increase of over \$210 million dollars due to participants' higher available cash balances. The MLGIP is paying .06% as of October 31, 2013, compared to .14% last year. The 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 current administrator of the MLGIP, expires December 31, 2013. A request for proposal for a financial institution to provide investment and administrative services for the Maryland Local Government Investment Pool is in 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.

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

DEBT MANAGEMENT DIVISION

Ratings

On July 11th and 12th, in conjunction with the sale of Maryland's General Obligation Bonds State and Local Facilities Loan of 2013, Series A and B, 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.

On July 19, 2013 Moody's revised its outlook for Maryland's Aaa General Obligation bond rating from negative to stable. Since 2011, Moody's had assigned a negative outlook to Maryland's General Obligation Bonds due to its indirect linkages to the weakened credit profile of the U.S. government. In its report entitled *Moody's revises outlook to stable, affirms Aaa municipal ratings indirectly linked to US*, Moody's stated that the conditions that led to the return to a stable outlook on the U.S. government rating, which itself was revised by Moody's on July 18, 2013, reduced the affected issuers' (including Maryland) vulnerability to sovereign risk.

The Treasurer's Office anticipates that future budget and deficit actions by the U.S. government could affect Maryland's bond ratings.

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 First Series General Obligation Bonds in March, 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, it was very apparent to us that 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 rainy-day fund 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; however, potential federal fiscal consolidation could negatively affect near-term growth prospects; 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 steady economic recovery underway, which has stabilized revenues and allowed for continued funding of reserves.”

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 consolidation remains a risk to Maryland’s budget and long-term financial plan, we believe that the state is monitoring 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.” While noting “[b]ased on the reforms including those enacted in 2013, the state’s actuary projects that the system will be 80% funded by 2025, and it will achieve full funding by 2038”, 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, “The state’s below-average pension funded ratios continue to represent downside risk to the rating. Although the state has implemented various reforms, it 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.

Closed Financings - General Obligation Bonds

Since our last report, the State has had one successful bond sale. The 2013 Second Series was sold in a competitive sale on July 24, 2013 and totaled \$475,000,000. The proceeds will finance necessary capital projects, such as schools, community colleges, university projects and hospitals. The sale closed on August 6, 2013 and had two series.

The Series A bonds were tax exempt and provided \$435.0 million, at a true interest cost of 3.16%. The Series B bonds were taxable and totaled \$40.0 million. The 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 1.18%.

Closed Financing – Leases

The Capital Lease-Financing Program allows State agencies to acquire equipment and pay for those items over a three, five, or ten year time frame. Between June 7, 2013 and October 31, 2013, \$1.8 million in capital equipment was leased by State agencies through the State Treasurer's Office. On December 13, 2013, the State Treasurer's Office will finalize the financing of another equipment lease totaling \$369,247.

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.

2014 Financing Plans

The next general obligation tax-exempt financing, projected to total approximately \$500 million, is planned for early March 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 March.

Capital Debt Affordability Committee (CDAC)

General Obligation Recommendation

The Committee met on September 25, 2013 and considered a recommendation to increase the authorization assumption projected in the 2012 CDAC Report by \$75 million. After significant discussion, the Committee approved a total of \$1,160 million for new general obligation authorizations by the 2014 General Assembly to support the fiscal year 2015 capital program. The vote was 4-1, with the Comptroller voting against the proposed amount. The Committee specifically recognized that should the economic and fiscal information underlying its recommendation change significantly the Committee could reconvene and make any necessary modifications.

In addition to determining and recommending a prudent affordable authorization level for the coming year, the Committee also sets out planning assumptions for the State to use in its capital program planning process. The Committee's adopted planning assumptions project similar amounts in fiscal years 2016 and 2017 of \$1,170 million and \$1,180 million, respectively. The planning assumptions in fiscal years 2018 and 2019 increase to \$1,275 million and \$1,315 million, respectively, and then decrease to \$1,280

million in fiscal year 2020. Beginning in fiscal year 2021, it is projected that the planning assumption will increase annually by approximately 3% over the previous year through 2023.

With these debt levels, the debt affordability ratios remain below the CDAC benchmarks of 4% debt outstanding to personal income and 8% debt service to revenues. The affordability analysis presented at the Committee's meetings indicates that the Committee's projection of General Obligation Bond authorizations will continue to be affordable (within debt guidelines) going into the future. The debt outstanding ratio peaks at 3.73% of personal income in fiscal year 2018 and declines to 3.46% in fiscal year 2023. The debt service ratio increases annually to 7.70% of revenues in fiscal year 2018, and declines to 7.65% in fiscal year 2021 before reaching 7.85% in fiscal year 2023.

The Committee recognizes that there are multiple annual authorization levels and patterns that would result in adherence to the benchmarks, depending on future levels of personal income and State revenue. The Committee's planning assumptions for future authorizations will be reviewed in preparation for the 2014 Report in light of updated revenue and personal income projections and authorization levels may be adjusted to adhere to these affordability benchmarks.

Academic Facilities Bonds Recommendation

Based on its review of the condition of State debt in light of the debt affordability guidelines, the Committee recommends a limit of \$32 million for new academic facilities bonds for the University System of Maryland for fiscal year 2015.

The 2013 CDAC meeting materials are available and the Capital Debt Affordability Report will soon be available on the State Treasurer's website at <http://www.treasurer.state.md.us/debtmanagement/cdac-reports.aspx>.

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 Capital Debt Affordability Committee's 2013 Report will include updated projections for the Annuity Bond Fund after the issuance of the 2013 Second Series Bonds. A General Fund expenditure is projected in fiscal year 2015, assuming current property tax rates of 11.2 cents per \$100 of assessed value of real property other than that of public utilities and 28 cents per \$100 of assessed value of real property of public utilities are not changed and other assumptions, including no bond premiums, remain as currently projected. Any bond premiums would reduce the General Fund subsidies required.

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

The State-owned aircraft policy renewed effective June 30, 2013 with the incumbent carrier, AIG Aviation. The hull values were up from \$55 million to \$139 million, which is a 139% increase, due to the Maryland State Police Aviation Command taking delivery of the first of their new AW-139 helicopters. The expiring premium and broker fee was \$657,043, and the renewal premium was \$967,246, which is an increase of \$310,203, or approximately a 47% increase. The rate of premium increase is much lower than the rate of the value increase because the carrier agreed to add the new helicopters at a reduced premium recognizing that all of the new helicopters would not be fully operational until training was complete.

The Maryland Transit Administration (MTA) excess liability coverage renewed effective July 1, 2013 with an extra \$20 million in liability protection. The expiring premium and broker fee was \$4,767,530, and the renewal premium and broker fee is \$4,767,598, an increase of only \$68 for \$20 million more in limit protection.

The Maryland Transit Administration (MTA) rail car property coverage renewed effective July 1, 2013. The rail car values were up from \$982 million to \$1.1 billion which is approximately a 14% increase. We renewed with the incumbent carrier, Ace, who reduced our rate by 12%. The expiring premium and broker fee were \$618,284, and

the renewal premium and broker fee is \$618,284, so MTA's costs did not go up even with increased values.

The Maryland Aviation Administration airport liability coverage for both BWI and Martin airports renewed effective August 15, 2013. The expiring premium and broker fee were \$339,202, and the renewal premium and broker fee is \$283,352, **saving MAA \$55,850.**

The statewide Boiler and Machinery coverage renewed effective September 30, 2013. The renewal values were up almost 3%. We renewed with the incumbent carrier, Zurich, who gave us a rate reduction of over 13%, without reducing the infrared testing services. The expiring premium and broker fee was \$362,897, and the renewal premium and broker fee is \$323,570, **saving the State \$39,327.**

The three terrorism policies providing coverage for State-owned property exposures renewed October 13, 2013, with the same coverage and limits. The expiring premium was \$518,500, and the renewal premium is \$496,000 with increased values, **saving the State \$22,500.**

The Maryland Transportation Authority liability coverage for toll bridges, tunnels, and the Inter County Connector renewed effective October 17, 2013. The broker offered an optional quote for Law Enforcement Liability (LEL) to include the exposures at BWI airport, the Port of Baltimore, and the World Trade Center. The expiring premium and broker fee was \$511,717, and the renewal premium and broker fee is \$537,207, which increased the terrorism coverage by \$118 million and added the new LEL coverage with a \$5 million limit and the premium only went up \$25,490.

The Underwriting Unit frequently addresses agencies' questions about commercial insurance and self insurance coverage and has worked on special projects with at least six State agencies.

- State Highway Administration had three agreements with Amtrak and the Underwriting Unit was asked to assist them with the insurance requirements of each. One agreement has been signed and fully executed. The Unit is waiting to hear the results of negotiations on the remaining two agreements.
- Frostburg State University requested our input on insurance requirements for a Civil War era artifact that was being loaned to them. It was a Washington Hotel register and would be on display off of their campus, at the University System of Maryland – Hagerstown.
- Archives asked for assistance regarding insurance during the transportation out-of-state for a borrowed 18th century desk believed to have once been used in the Old Senate Chambers when Congress was meeting in Annapolis. The 18th century desk was being examined by an internationally recognized conservator.

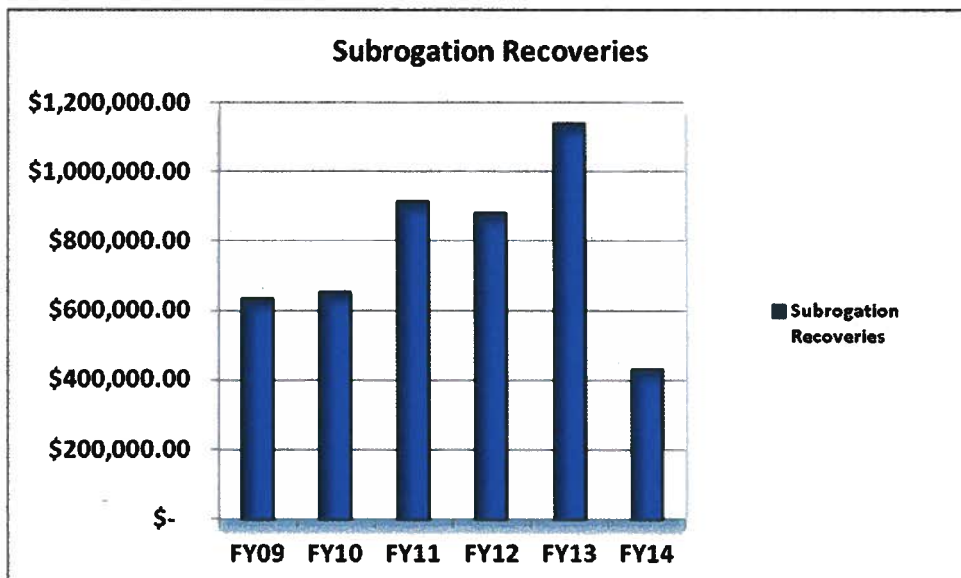
- University of Maryland, Baltimore County had questions about fine art that will be on loan to them that they are planning to send out for a foreign exhibition. We arranged for and conducted a conference call that included our broker who is a fine art insurance expert.
- Maryland Port Administration consulted with the Unit on insurance requirement questions related to the Port's America Chesapeake Agreement for Seagirt Marine Terminal. The Unit reviewed the documents supplied by the Port and consulted with our marine broker. A lengthy conference call was held between the Port and the Unit to address all of their questions, which should also assist them with future insurance requirements in their agreements and contracts.

Claims Unit

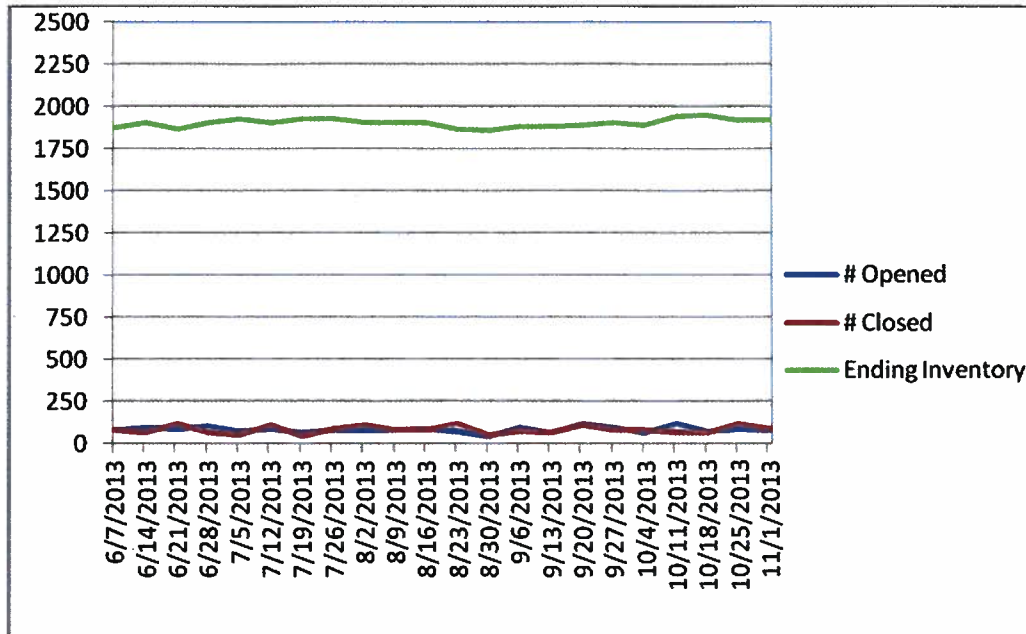
The Claims Unit investigates and resolves liability claims filed under the Maryland Tort Claims Act, Md State Gov't Code Ann. §12-101 *et seq.* The Unit also handles claims for damage to State-owned property arising from sudden and accidental perils such as collision and comprehensive losses to autos,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

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

The year-to-date subrogation recoveries for fiscal year 2014 total is \$429,725.33; total recovery for fiscal year 2013 is \$1,065,002; 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 June 7, 2013 through October 31, 2013, 1,771 claims were opened, and 1,719 claims were closed; which reflects a 1:0.3 open-to-close ratio.

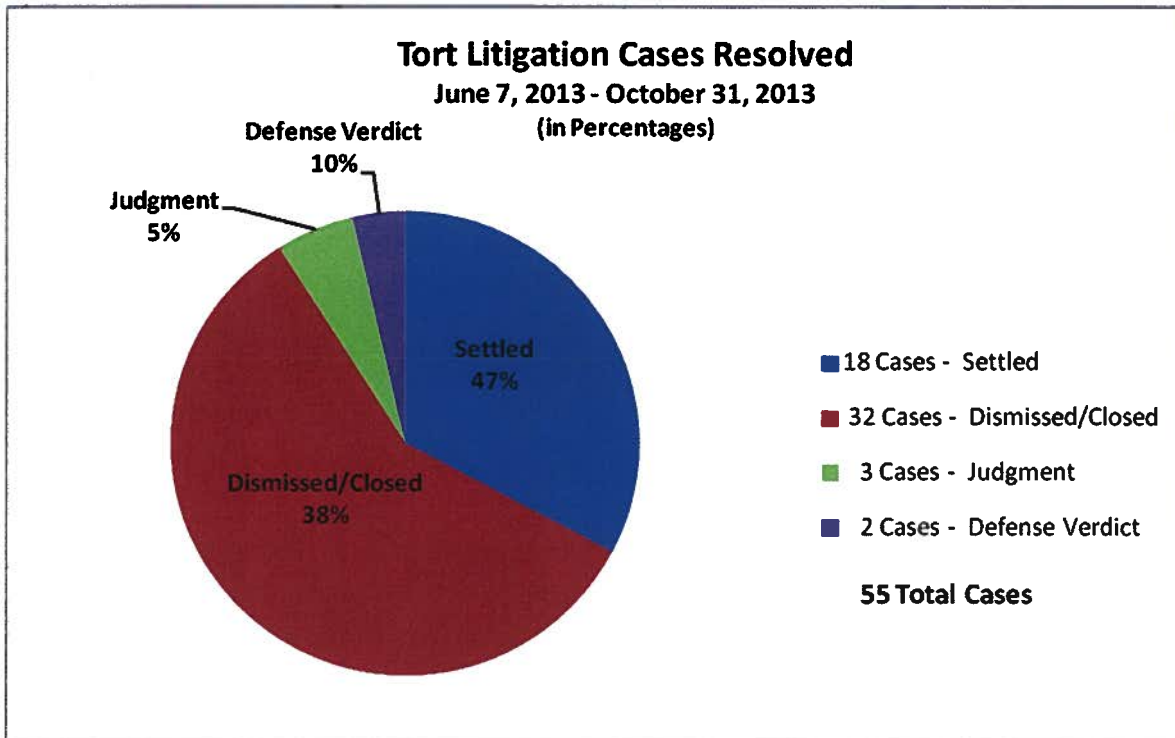


Tort Litigation Management

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

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

The Tort Unit handles a rolling docket of approximately 110 - 120 litigation claims. The Litigation Manager actively monitors trial verdicts and appeals and assesses the potential impact on the State Insurance Trust Fund. The Litigation Manager also analyzes the data in order to track the litigation outcomes. The disposition of the cases disposed of between June 7, 2013 and October 31, 2013, 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.

In preparation for the 2013 hurricane season, the Loss Prevention Manager invited State agencies and universities to participate in a “Hurricane Preparedness” webinar. The presentation included elements of a hurricane emergency plan, and what precautions and preparations to take before, during and after a major windstorm event to prevent or mitigate property losses.

In July 2013, the Loss Prevention Unit began conducting monthly and quarterly loss reviews. Quarterly loss summary reviews were completed in October 2013, and distributed to agencies with frequent or severe claims. Meetings are being scheduled with the various agencies having the highest loss frequencies recorded monthly and/or quarterly. The Loss Prevention Manager and the Claims Unit are scheduled to meet with Maryland Transportation Authority in November 2013 and the State Highway

Administration in December 2013, to discuss claims frequency and preventable accidents related to road hazards, maintenance, operations and contractors.

In September 2013, following an influx of auto claims involving the Department of Natural Resources (Maryland Conservation Jobs Corps) Summer Youth Program, the Loss Prevention Manager met with the Program Director and Manager to discuss recent claims, prevention strategies and administrative controls to help reduce the frequency and improve the reporting processes. The Loss Prevention Manager is scheduled to follow-up with the agency in June 2014, when it conducts the next program training session to discuss accident reporting and loss prevention measures.

Property inspections are conducted to identify property exposures and provide recommendations to mitigate exposures, which may be the result of deficiencies in fire protection, construction or special hazard protection. In July 2013, the Loss Prevention Manager attended property inspections conducted at the University of Maryland Baltimore Medical School Teaching Facility and School of Pharmacy, and the University of Maryland University College, Inn and Conference Center. In September 2013, similar inspections were conducted at Department of Public Safety and Correction Services' Baltimore City Detention Center and Central Booking. Other locations slated for scheduled inspection include University of Maryland College Park campus, University of Maryland Baltimore County, and the College of Liberal Arts at Towson University.

Once the property inspections have been completed, the carrier will submit their reported findings for corrective action. These findings are then reviewed by Loss Prevention, forwarded to the appropriate agency for review, and to submit a plan of action or comment on the outlined recommendations. Follow-up is then scheduled with the agencies to discuss any corrective plan of action, until all recommendations agreed upon have been implemented.

- University of Maryland Baltimore Medical School Teaching Facility and School of Pharmacy have received their inspection results, submitted responses and/or have implemented corrective action plans. The responses have been forwarded back to the carrier, for future renewals.
- The Unit is awaiting property inspection reports from University of Maryland University College, Inn and Conference Center and Department of Public Safety and Correction Services' (DPSCS) Baltimore City Detention Center and Central Booking. The property insurance inspection reports are expected in November 2013, from the carrier.

The Electrical Infrared Testing program, for the current policy year, was completed in September 2013. The test 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. Participating schools and agencies included the University of Maryland, Baltimore, the University of Maryland, Baltimore County, the University of Baltimore, Maryland Military Department, and the Department of Health and Mental Hygiene.

- The results have been received and reviewed by Loss Prevention from the carrier.
- At this time, all of the above participants for the 2013, Electrical Infrared Testing Program have received the testing results, and completed the corrective plan of actions.

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.