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INTERAGENCY COMMITTEE ON SCHOOL CONSTRUCTION

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**PUBLIC SCHOOL CONSTRUCTION IN MARYLAND
THE CAPITAL IMPROVEMENT PROGRAM
Report to the Capital Budget Subcommittee
Senate Budget and Taxation Committee
Senator James E. DeGrange, Sr., Chair
Senator Douglas J. J. Peters, Vice-Chair**

David Lever
Executive Director, Public School Construction Program
March 21, 2011

We appreciate the opportunity to report on the status of public school construction in Maryland. Since FY 2006, this Committee has supported a consistently high level of funding for school construction, demonstrated through the many projects that are under construction in every part of the state. I believe I speak for schools and communities throughout Maryland when I express my thanks for your support. Your decision to allocate funds to school construction in a time of severe fiscal constraint demonstrates the high priority that you have given to education.

The \$1.9 billion in funding that has been allocated between FY 2006 and FY 2011 through the Capital Improvement Program has allowed almost 1,000 projects to move forward. These include 88 kindergarten and pre-kindergarten projects in fulfillment of the requirements of the Bridge to Excellence in Education Act of 2002: 151 new and replacement schools; 177 major renovations, renovations with additions, and limited renovations; 33 additions; 21 high school science classroom renovations; and 499 systemic renovations of individual building systems. In addition, \$84.7 million has been allocated through the Aging Schools Program and the Qualified Zone Academy Bond Program for renovation and repair work in existing schools. The distribution of funds has supported the policy of "Fix it First": approximately 61% of the total allocation has been directed at projects in existing schools.

I. FISCAL YEAR 2012 PUBLIC SCHOOL CONSTRUCTION CAPITAL IMPROVEMENT PROGRAM

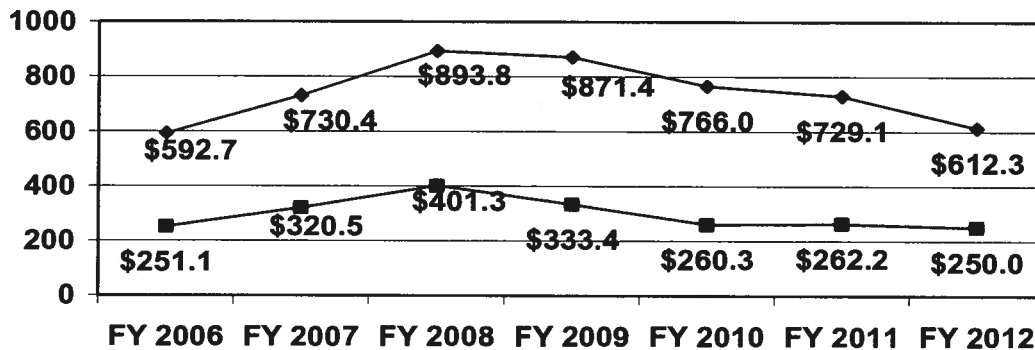
A. School Construction Requests and Allocations, FY 2006 through the Present

In the fall of 2010, the Interagency Committee on School Construction (IAC) received a total of \$612 million in requests for 244 FY 2012 projects, a decrease of about 17% compared to the value and number of requests submitted in FY 2011. The FY 2012 CIP also includes 61 requests for planning approval for major construction and kindergarten projects, a decline from the 83 projects requested in FY 2011. We believe that this fourth year of decline in funding and planning requests does not represent a lessening of need with respect to facility deficiencies, but results from the fiscal constraints that local governments have experienced during the economic downturn. A number of major projects have been deferred outright, and local boards have had to make difficult choices between carrying out major projects or the small systemic renovations that effectively extend the useful life of a building.

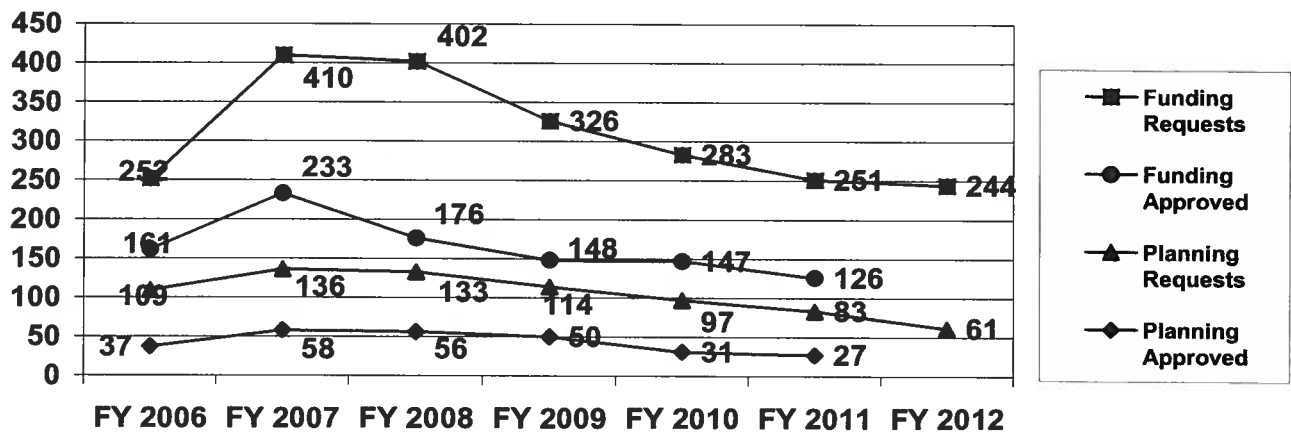
The following charts show the general trends since FY 2006 in the value and number of the project requests in each year's CIP, and the total funding allocated or projected:



FY 2006 - 2012 CIP Requests and Funding



FY 2006 - 2012 CIP Planning and Funding Project Requests



B. Driving Factors in the FY 2012 CIP

Despite the continuing decline in CIP requested projects, the value of the FY 2012 requests is still more than double the available funding. A number of factors drive the need for large levels of school construction funding:

- **Enrollment Growth.** There is continuing enrollment growth in a few jurisdictions, particularly Montgomery County, most likely because the economic recession has led a number of households to choose public school over the cost of private school. Baltimore City continues to see student enrollment increases for the third year in a row. A few smaller jurisdictions have experienced unexpected growth as families relocate to live with relatives.
- **Renovation and replacement of older facilities.** The decline in enrollment growth in a number of jurisdictions has allowed many LEAs to turn their attention to renovation of the existing school plant. The years of rapid growth, in which school construction funds were necessarily targeted at building new capacity, have left many LEAs with a large backlog of renovations and system upgrades that need to be carried out in their existing facilities.

- **Maintenance and Capital Funding.** The increased attention to existing facilities is also reflected in a greater focus on maintenance; however, there is still concern that local maintenance budgets may be reduced while the LEAs' backlogs of facility deficiencies continue to increase due to normal aging and other causes. There is a direct correlation between adequate capital funding and maintenance: good maintenance defers the need for major capital investments in school buildings, and conversely adequate and well placed capital projects significantly reduce the maintenance backlog for LEAs. One LEA has reported that the State's funding for systemic renovations is critical in allowing them to correct deficiencies proactively rather than responding to system failures and emergencies after the fact.
- **Construction Costs.** Although construction costs remain low due largely to the increased competition that has resulted from the economic downturn, there are indications that this situation will change within the next year. Commodity and materials costs are projected to increase, and contractors are showing reduced interest in certain large school construction projects compared to mid-2010.
- **High Performance Building Design.** Thirteen school systems report a total of 47 LEED certification school facilities in various stages of planning, design, construction and occupancy, including eight renovation or renovation/addition projects.¹ Although high performance design and construction are increasingly becoming the norm among public owners, there is still a premium for achieving high performance certification.
- **Base Realignment and Closure (BRAC).** To date, no school system has reported an urgent BRAC-generated capacity or programmatic need; all have been able to accommodate growth within their existing capacity. The IAC has several policies that will allow for a flexible and rapid response to enrollment changes when they do become apparent (see page 4). There continues to be little evidence on where or when households will relocate, how many children they may have, how old the children will be, whether or not they will have special learning requirements, or family preferences with regard to sending children to private school.

C. Corollary Policy Objectives

As a large vehicle for capital investments, capital funding for school construction supports a number of related policy objectives:

Minority Business Enterprise Participation.

Between FY 2008 and FY 2011 to date, the total MBE participation in projects funded through the Public School Construction Program increased steadily from 12.5% to 24%. New procedures approved by the IAC in June 2008 and adopted by local boards in the autumn of 2008 have led to realistic goal setting and have stimulated noticeably greater attention to this issue among the school districts; new reporting techniques instituted in FY 2011 capture real-time bidding activity under the new procedures. We have not, however, seen a corresponding decrease in the number of approved waivers. Our consistent emphasis has been on clarifying and improving the MBE procurement process, including the training and counsel that we regularly give to LEA procurement officers and MBE liaisons, with the expectation that this focus will result in increased participation and a reduced number of waivers.

Public School Funding and Community Development. State capital funding decisions for public school construction have a direct impact on the location of residential development. The Interagency Committee encourages neighborhood schools that support Maryland's growing body of Smart Growth policies. The IAC participates directly in the Sustainable Growth Commission, the Smart Growth Coordinating Council, and the Maryland Department of Planning PlanMaryland effort.

¹ LEED refers to Leadership in Energy and Environmental Design, a widely-accepted ranking system established by the U. S. Green Building Council.

BRAC Readiness

The IAC has approved four policies that will help to address BRAC impacts in advance: (1) requests for BRAC-eligible projects may be submitted after the deadline of December 1, 2010 for submission of FY 2012 CIP amendments; (2) a BRAC-eligible project that is requested for planning approval may receive additional consideration in the assessment of planning priorities; (3) a capacity project that has a verifiable linkage to BRAC may be eligible for additional State funding after the completion of construction if an increase of enrollment can be attributed to a BRAC change; and (4) a request for a new or replacement BRAC-eligible project that does not meet the IAC's normal enrollment justification criteria for State participation can still be eligible for State participation under an alternative method for determining future enrollment and State participation. The PSCP regularly participates in the BRAC Stat reporting process of the Lieutenant Governor's BRAC Sub-Cabinet.

II. BUDGET ANALYSIS

A. Public School Construction Program (Statewide) – DE0202A

1. State Proceeds from Sold or Leased Facilities

DLS requests that IAC comment on whether Section 5-301 of the Education Article should be amended to specify that the State should be paid its share of the value of a facility based on the depreciated value, not negotiated lease revenues, with the proceeds being deposited into the Annuity Bond Fund to retire debt service (DE0202A, page 7).

The large majority of school facilities processed by the BPW for closure, transfer to the county government, and disposal are sold, not leased. In these instances, there is only a single transaction of revenues in which the State shares. At the culmination of the sale transaction, the State receives its share of the cash proceeds from the sale, and there is no further need for monitoring or collection of proceeds. The State share of the sale proceeds is based on the appraised value of the property being sold. In order for the State to gain the maximum return on its investment of funds, the State's share should continue to be based on the appraised value of the property rather than on its depreciated value, as the former will generally be higher than the latter.

With regard to transferred school facilities that are leased rather than sold, we believe that county governments will be reluctant to pay the State the entire value of the property at the time the lease is consummated, irrespective of whether the value is based on the depreciated value or the appraised value. Experience has shown that some lease arrangements may be prematurely terminated, resulting in no proceeds being available to the county. In other circumstances, leases have been amended with respect to the lease terms, the lease amounts, or other conditions. Given these uncertainties, if the county paid the State the full value of the property at the time of sale, it would be committing a large amount of funds with no guarantee that it could realize any lease proceeds at all.

B. Aging Schools Program – DE0202B

1. Recommendation

We concur with the DLS recommendation regarding the provision in the Budget Reconciliation and Financing Act of 2011 that will permanently authorize either general funds or general obligation bonds to fund the Aging Schools Program.

Rationale: While the local educational agencies (LEAs) generally prefer the use of Paygo funds to support Aging Schools Program projects because of their flexibility, they also have ample projects that can be carried out using bond proceeds. The ASP is a very popular program, not only because there is no local match requirement, but also because it supports

projects that are too small for the Capital Improvement Program but too large for the local maintenance and repair budget. These projects often have a noticeable effect on the indoor environmental quality of a school and its aesthetic appeal as a learning environment.

C. Qualified Zone Academy Bonds – DE0202AQ

IAC should brief the committees on its efforts to help school systems expend QZAB funds. Also, the IAC should include the Maryland Charter School Network or a similar organization in its communications to school systems about QZAB funding. (DE0202AQ, page 4).

Recognizing the difficulties that school systems have had in the past in placing QZAB-funded projects under contract, complete the work, and request reimbursement from the State, we have put in place a number of protocols that are proving to be beneficial:

Allocations Through FY 2011:

1. Regular contacts are made via telephone and email to LEAs to ask about project status, remind them of deadlines for submissions, and assist with technical issues.
2. Local superintendents are now included in the correspondence regarding the status of QZAB projects so that they will be aware of the importance of expediting the projects with the proper allocation of staff and other resources.
3. A consultant has been engaged to work directly with the LEAs to expedite the progress of the projects through correspondence, letters, and emails.
4. Through newly instituted quarterly meetings between our staff and the staff of the State Treasurer’s Office and DBM, the Treasurer has played an active role in bringing the urgency of timely project execution to the attention of school system executives.

These measures appear to be successful, as shown by this summary of current activity as well as activity projected for the balance of calendar year 2011:

Unexpended Balance as of January 1, 2011:	\$17,976,942	(1)
Unexpended Balance as of March 1, 2011:	\$14,541,373	(1)
Expenditure Requests Currently in Process:	(\$1,759,889)	
Expenditure Requests Anticipated by September 1, 2011:	(\$2,537,813)	(2)
Expenditure Requests Anticipated by December 1, 2011:	(\$4,525,415)	(3)
Anticipated Unexpended Balance by December 2011:	\$5,718,256	
Portion allocated to projects to FY 2011 projects:	\$4,266,481	(4)
Unexpended Balance of Concern:	\$1,451,775	(5)
Portion allocated to other than FY 2011 projects:	\$591,717	
Portion unallocated to projects:	\$860,058	

NOTES:

- (1) Includes all previous allocations, and FY 2011 allocation.
- (2) Based on most recent expenditure report, and commitments from LEAs.
- (3) \$3.1 million is for projects in Baltimore City and \$901,000 is for projects in Prince George’s County. The balance is for four projects in two LEAs.
- (4) These projects are in various stages of planning, design or construction; reimbursement is not required prior to December 31, 2012.
- (5) \$155,875 of this amount of bonds is liable to be called if not expended by December 31, 2011.

From this summary, it is clear that the focus of the PSCP between now and December 1, 2011 must be on three issues:

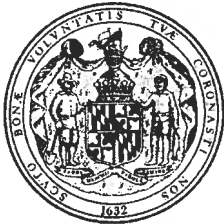
1. Ensure that anticipated requests for expenditures (\$7,063,228) are submitted.
2. Ensuring that other requests for expenditures (\$591,717) are submitted.
3. Allocating a balance equal to \$860,058 to projects and ensuring projects are completed and requested.

FY 2012 Proposed Allocation

House Bill 86 / Senate Bill 122 will authorize the sale of \$15.9 million in QZAB funds made available to Maryland through the federal American Reinvestment and Recovery Act (ARRA) of 2009. With the past history of the QZAB program and the new federal requirements regarding encumbrance and expenditure in mind, we have worked with the State Treasurer's Office and the Department of Budget and Management to shape legislation that provides greater flexibility to the IAC in the allocation of funds. We have outlined the advantages of this approach in both our bill testimony of February 22 and our letter to this committee dated March 7, 2011 (copies attached). We believe that the distribution of QZAB funds through the Breakthrough Center and a competitive grant process will expedite every aspect of the program, from acquisition of the 10% private entity contribution to project execution and the request for reimbursement.

We will work with the Maryland State Department of Education Office of Charter Schools to alert the charter school community to the possibility of accessing QZAB funds. The LEAs are already aware that QZAB funds, similarly to other State school construction funds, can be used for projects at charter schools that are located in facilities that are titled to the local board of education.

Attachments



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CHAIRPERSON

March 7, 2011

The Honorable Edward J. Kasemeyer, Chair
Honorable Members of the Committee
Senate Budget and Taxation Committee
Miller Senate Building
Annapolis, MD 21201

Re: Senate Bill 122, Creation of a State Debt - Qualified Zone Academy Bond

Dear Senator Kasemeyer and Members of the Committee:

We wish to clarify certain points regarding Senate Bill 122, Creation of a State Debt - Qualified Zone Academy Bond (QZAB), raised during testimony before the Committee. As you know, the QZAB program has characteristics that make it exceptionally difficult to administer and have resulted in a delayed expenditure of funds. The proposed legislation would restructure the FY 2012 QZAB process to ensure that project procurement, execution, and reimbursement occur more smoothly and rapidly than in past years, and that funds are aligned with needed projects. Under federal law, QZAB proceeds must be spent within three years. Failure to expend these funds within the three year timeframe would have serious consequences for both the investors in these bonds and the State. Specifically, the bonds would have to be "called" and investors would lose the tax credits. As you probably know, the State has never called these bonds, and having to do so would jeopardize our ability to issue these bonds in the future.

In current and past testimony we have shown that delays have been experienced in expending the QZAB funds because some Local Education Agencies (LEAs) had difficulty obtaining and confirming the required 10% private entity contribution and because the complex administrative and paperwork requirements of the program have imposed a very large burden on LEAs that often lack sufficient central office staff. The proposed legislation will assign a portion of the FY 2012 QZAB allocation to Breakthrough Center projects, allowing Maryland State Department of Education (MSDE) to play a central role in quickly meeting the private entity contribution requirement as well as providing detailed, periodic monitoring of project status. Concurrently, the allocation of funds to a relatively smaller number of projects through a competitive application process, in which project management is a qualification factor, will result in faster project execution.

To assist in achieving the goal of more rapid project execution, flexibility should be provided to the Interagency Committee on School Construction (IAC) in determining eligible projects, and the traditional QZAB formulaic distribution of funds should be eliminated. If the formulaic approach is applied to the FY 2012 QZAB authorization, difficulties in expending the funds in a timely manner will continue and funding discrepancies will result. In anticipation of the authorization of the FY 2012 QZABs, in November 2010 our office requested the school

districts to submit preliminary expressions of interest. Seventeen LEAs responded with \$11.8 million in Breakthrough Center projects and \$21.4 million in competitive grant projects:

- Five LEAs that are eligible for FY 2012 funds either declined explicitly or did not submit a project description; under the formula approach, \$2.2 million assigned to these districts would need to be redistributed to other LEAs.
- Eight LEAs requested less than they would have received if the funds were distributed by formula, leaving an additional \$1.6 million to be redistributed to other LEAs. We assume that these LEAs requested a lower amount because of administrative limitations.
- Nine LEAs requested more than they would have received if the funds were distributed by formula, for a total of \$12.5 million. Two of these LEAs, Charles County and Dorchester County, will not be able to carry out any of their requests if the funds are distributed by formula because the value of their smallest request exceeds their formula-driven allocation.

Because five eligible LEAs did not submit projects and eight LEAs requested less than they could have, funds are available to support projects that exceed the formula amounts, as well as to provide equitable funding for larger LEAs like Baltimore City, Baltimore County, Montgomery County, and Prince George's County that have traditionally received large allocations by formula. Baltimore City and Prince George's will receive an assured amount of funding under the Breakthrough Center portion of the funding, and will still be able to apply for additional grants under the competitive portion.

These equitable results would not be possible if the IAC is bound to distribute funds in accordance with the traditional QZAB formula, which worked well at the beginning of the program but has been found to be too rigid. Because considerable work remains in order to determine project eligibility and scope, we request that flexibility be granted to the IAC in assigning funds, rather than requiring funds to be distributed by a pre-arranged method.

We also note that the average size of the projects submitted in response to our November inquiry is about 2-1/2 times the size of typical past QZAB projects. In general, this will make the administration of the program somewhat simpler for the LEAs, resulting in faster project delivery times and a more timely expenditure of the funds. This goal will be enhanced by the Breakthrough Center projects: the Center will collaborate with the LEAs to obtain the 10% private entity contribution through discounts and *gratis* professional development services provided by vendors of computer hardware and software. On three pilot projects conducted in 2009, this access to donations allowed the private entity contribution requirement to be met within months of the project start. The QZAB proceeds allocated to Breakthrough Center projects will not only support MSDE's efforts to improve student achievement in low performing schools, they will improve the overall performance of the QZAB program.

With this additional information and the testimony we presented on February 23, we request the Committee to report favorably on Senate Bill 122, Creation of a State Debt - Qualified Zone Academy Bond. The changes to the QZAB program shown in the bill have a compelling urgency, because federal requirements regarding the timing of QZAB encumbrances and expenditures could place the large FY 2012 authorization at risk if they are not met.

The Honorable Edward J. Kasemeyer, Chair and Members of the Committee
March 8, 2011
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Please do not hesitate to call me if you have any questions about the information in this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "David Lever". The signature is stylized with a large, looped initial "D" and a trailing flourish.

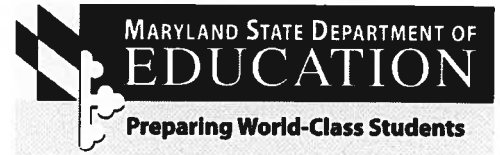
David Lever

Enclosures

cc: The Honorable Nathaniel J. McFadden, Vice-Chair, Budget and Taxation Committee
The Honorable Richard S. Madaleno, Jr., Chair,
Education, Business and Administration Subcommittee
Governor Martin O'Malley, State of Maryland
Mr. Peter Franchot, Comptroller, State of Maryland
Ms. Nancy K. Kopp, Treasurer, State of Maryland
Dr. Nancy S. Grasmick, Chair, Interagency Committee on School Construction
Mr. Alvin Collins, Member, Interagency Committee on School Construction
Mr. Richard Hall, Member, Interagency Committee on School Construction
Mr. Timothy Maloney, Member, Interagency Committee on School Construction
Mr. Frederick Puddester, Member, Interagency Committee on School Construction
Ms. Joan Schafer, Deputy Director, Public School Construction Program
Mr. Robert Crocetti, Director of Fiscal Services, Public School Construction Program
Ms. Kim Spivey, Program Manager, Public School Construction Program
Mr. Robert Glascock, Maryland State Department of Education
Mr. Chad Clapsaddle, Department of Budget and Management
Steve Vanderbosch, Esq., Office of the State Treasurer
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SENATE BUDGET AND TAXATION COMMITTEE
 February 22, 2011

TESTIMONY IN SUPPORT OF SENATE BILL 122, CREATION OF A STATE DEBT – QUALIFIED ZONE ACADEMY BONDS

The Public School Construction Program and the Maryland State Department of Education are pleased to testify in support of Senate Bill 122 regarding the creation of a State debt for the issuance of Qualified Zone Academy Bonds (QZAB) in FY 2012, and in support of specific provisions of the bill regarding the method of allocating the bond proceeds. In this testimony, we will outline the rationale for changing the traditional process for the allocation of QZAB funds in Maryland, and will explain the proposed process for the distribution of FY 2012 QZAB funding.

Background

The QZAB program was established by Congress in 1997 in order to provide funds for the renovation of school facilities in federally-designated empowerment zones and in schools serving lower-income communities. Since inception of the program, Congress has authorized between \$4.5 and \$9.8 billion annually in tax-credit bonds. In contrast to owners of tax-exempt bonds, holders of QZABs receive a federal tax-credit that is equivalent in value to the interest they would receive under a tax-exempt municipal bond; the issuer also has the option of issuing the bonds with interest payments and receiving a cash subsidy from the federal government as opposed to providing bondholders with a tax credit. Tax credit QZABs are advantageous to the issuing authority because they do not require a payment of interest. The federal QZABs carry three conditions: the proceeds must be used in schools in which the population of students in the Free and Reduced Price Meal (FRPM) program is at least 35% of the total student population, the programs offered at the school are designed in cooperation with the business sector, and a private entity is required to make a contribution equal to at least 10% of the value of the improvements toward the school. These latter two requirements are intended to involve the private sector, particularly the business community, in the improvement of school facilities. The private entity contribution can be any combination of funds, equipment, supplies, or in-kind services. Since 2008, the federal government has required that 10% of every QZAB issuance must be encumbered within six months of the sale of the bonds, and the expenditures must be fully reimbursed within three years of the sale.

When Maryland authorized its initial QZAB sale in 2000, the General Assembly decided that the State would issue the bonds on behalf of the school systems. The Interagency Committee on School Construction (the IAC) determined that funds would be allocated on the basis of a formula that accounted for two factors: each local educational agency's (LEA's) proportion of pre-1960 un-renovated square footage, and each LEA's proportion of students in the Free and Reduced Price

Meal (FRPM) program. This approach differed from that of other states, in many of which the QZAB authorizations were made available directly to LEAs on a first-come-first-served application basis and the LEAs were responsible for the sale of the bonds. In the Maryland formula, LEAs that had no qualifying schools received no allocation, and no eligible LEA received an allocation of less than \$30,000. Minimum project size was set at \$30,000 and unused project funds were allowed to be reassigned to the school for purposes outside of the construction project, for example materials, supplies, or professional development. Eligible project scopes are similar to those for Aging Schools Program projects; neither of these programs allows for the construction of new schools or additions to existing buildings.

The 10% private entity contribution requirement has proven to be troublesome for many LEAs, for a multitude of reasons. Seeking interested donors is in itself a time-consuming activity which has in some cases delayed the implementation of approved QZAB projects. As the interest of corporate donors has decreased markedly since inception of the program, the typical source of the private entity contribution in recent years has been community and parent groups such as PTAs and PTSOs. Their donation typically takes the form of in-kind services performed by parents in the school for a period of up to 14 years. Although this is certainly a worthy source of community contribution, it does carry a large administrative burden, since the separate contributions of a few hours at a time made by multiple individuals must be tracked over a very long period of time. This administrative task may not always be a priority among school staff, and LEA central offices have found it difficult, among their multitude of other facility tasks, to find the staff resources to track the contributions. In addition, in some LEAs the number of schools that meet the 35% minimum FRPM criterion is limited, and it has become increasingly difficult to find new projects that can qualify for QZAB funding. The new federal rules require the application of Davis-Bacon wage rates to QZAB funded projects, increasing their cost. The administrative costs have been so great that in some cases LEAs have turned down their formula-approved allocations of QZAB funds. Given the great need that all school districts in Maryland have to upgrade their older buildings, this action indicates how burdensome the QZAB requirements can be.

Partly because of these administrative difficulties, a large proportion of prior-year QZAB authorizations has not been expended, even for projects that have been completed. The Public School Construction Program has been in frequent communication with the recipients of QZAB funds to ensure that the projects are placed under contract, completed, and requested for reimbursement in a timely manner.¹ As of March 2, 2011, a consultant will be engaged using an allowable portion of the QZAB funds to supplement the PSCP effort in this regard. Based on the number of requests for reimbursement that have been submitted since January 1, 2011, we anticipate that the total backlog of unexpended QZAB funds will decrease significantly by the end of calendar year 2011. However, since it appears that the major cause of this situation has been the difficulty associated with the 10% private entity contribution requirement, the Interagency Committee, the Office of the State Treasurer, and the Department of Budget and Management recommend the changes that are shown in the proposed legislation.

The FY 2012 Qualified Zone Academy Authorization – SB 122

While the federal QZAB program dates to 1997, the authorization under consideration is unprecedented in its size. As a component of the American Recovery and Reinvestment Act of 2009, Congress increased the total authorization of QZAB for the nation to \$11 billion in each of 2009 and 2010, for a total of \$22 billion. Maryland's QZAB portion, based on a federal formula that assigns authorizations based on each state's proportion of individuals below the poverty line as defined by the Office of Budget and Management, is \$15.9 million for 2009 and \$15.4 million for 2010. By contrast, Maryland's authorizations in recent years have ranged from \$5 million to \$11

¹ In addition to frequent emails and telephone calls to QZAB recipients, unexpended project status reports are sent to each of the LEAs several times during the year.

million. The 2009 federal authorization of \$15.9 million corresponds to the FY 2012 State authorization that is the subject of SB 122. We note that the ARRA stipulates that the 2009 federal QZAB authorization must be issued prior to December 31, 2011; if this bill is not passed by the General Assembly, the 2009 federal authorization will be forfeited.

As in previous years, school construction projects approved for funding under the FY 2012 authorization must be in schools in which at least 35% of the student population participates in the Free and Reduced Price Meal Program, and a private entity is required to make a 10% matching contribution consisting of in-kind services, equipment, or funding. In addition, the FY 2012 authorization will follow the stringent rules promulgated with the 2008 federal QZAB authorization, namely that approved projects must be under contract within six months of the sale of the bonds and must be reimbursed within three years of the issuance, on penalty of forfeiting the federal authorization.

The proposed legislation departs from past QZAB authorizations by the General Assembly in two important respects, described further below. The primary rationale for restructuring the QZAB program centers around the difficulty of expending the proceeds within the timeframe set out in federal law. The consequences of not expending the FY 2012 funding within the timelines established in federal law may have dramatic consequences for the State. The State would be required by federal law to execute a "mandatory call" of the bonds, which the State has never done in its history, and which would likely impact future marketability of State bonds. Because investors in QZABs lose their anticipated tax credits and/or interest earnings on called QZABs, the marketplace would likely assign greater risk to Maryland QZABs that would be reflected in fewer bids and higher interest rates for future Maryland QZAB offerings. To ensure against this possibility, two changes to prior practice are proposed:

1. The funds will be divided between traditional QZAB projects and projects associated with the Maryland State Department of Education Breakthrough Center.
2. The portion of the funds applied to traditional QZAB projects will be awarded competitively rather than on a formula driven basis.

Breakthrough Center Projects

The Breakthrough Center is an MSDE operation dedicated to coordinating, brokering, and delivering an array of support services to low-achieving schools and districts across Maryland. The Center is at the leading edge of Maryland's school turn-around work and gives high priority to integrating public and private services in order to support reform in underperforming districts and schools. It serves as the interface among MSDE, LEAs, and schools identified as chronically underperforming. The Breakthrough Center places strong emphasis on building administrative and instructional capacity in these districts and schools so that academic turn-around is not just achieved, but is sustained over long periods of time.

The Breakthrough Center has identified approximately 34 schools with the lowest academic achievement in the state; these schools are located in Baltimore City and Prince George's County. These schools will receive a concentration of services in order to effect a significant and lasting turn-around in student achievement. To support the mix of curricular, administrative, professional development, and computer technical support services that MSDE will provide to these schools, certain facility upgrades are needed in the schools. At this time, we are working with the two school districts to identify the scope of work for each of the schools. Once this initial scoping exercise is completed, a decision will be made as to the amount of FY 2012 QZAB funds that will be applied to each school, and whether certain projects can be deferred until FY 2013 when the federal 2010 authorization of \$15.4 million will be issued.

There are a number of advantages to applying a portion of the FY 2012 QZAB funds to Breakthrough Center projects:

- The Breakthrough Center collaborates with partner school districts to identify ready sources for the 10% private entity contribution. Examples of contributions include the discount on equipment costs offered by computer vendors as well as professional development training with a monetary value that can be offered *gratis* by the vendor. Many of these are one-time contributions, vastly simplifying the administrative effort of the LEA to track and calculate the value of the contribution. As noted, achieving the 10% private entity contribution in the past has been a major difficulty for some LEAs, leading in some cases to project delays and as well as delays in the expenditure of funds.
- A major component of Maryland's Race to the Top (RTTT) federal grant is the identification of the persistently lowest-achieving schools throughout the state. These are schools that are being restructured or are in danger of restructuring. Through the Breakthrough Center, MSDE has committed to work with local school districts to identify and implement improvement strategies to turn around and sustain school performance in the lowest-achieving schools. While this effort began before Maryland was awarded a RTTT grant in September 2010, the grant award brings increased urgency to the effort. The QZAB funds will generate facility improvements that will support MSDE's efforts to improve student achievement in these schools.
- We anticipate that a large number of the Breakthrough Center projects will be limited to upgrades of existing information technology systems to wireless (keeping the wired components for redundancy). These improvements are generally carried out by on-call contractors already engaged to the school system, substantially shortening the procurement process and hence the overall project schedule.
- Focusing a substantial portion of the Breakthrough Center portion of the QZAB funds on a limited number of larger projects will improve the ability of the PSCP to track, monitor, and report on the progress of the projects.

Competitive Award of Project Funding

The legislation proposes to award the portion of the funding that is not associated with the Breakthrough Center through a competitive application process similar to that used for the Capital Improvement Program. While the formulaic approach established for the Maryland QZAB program in 2000 worked well in the early years of the program, there are reasons to consider a change to a competitive process:

- Under the formula, some LEAs with worthy projects and valid private entity sources for the local match received allocations smaller than they could use; other LEAs received allocations larger than they could effectively spend, and a few even rejected their allocations.
- LEAs have had greatly varying records with respect to project management. As a consequence of the more stringent federal program deadlines promulgated in 2008, we believe it is essential for QZAB funds to be allocated to those LEAs that demonstrate a need and either have a track record of carrying out projects in a timely manner, or can show that they will have the institutional capacity to carry out projects funded with the FY 2012 QZAB bond proceeds within the required timeframes. Staffing and other LEA resources will in fact be used as criteria, among others, to determine which projects will be recommended for approval.

We have received expressions of interest from LEAs for more than \$17 million in FY 2012 QZAB projects (exclusive of Breakthrough Center projects). The average value of these projects is

considerably larger than the average value of past QZAB projects (\$115,000). Interestingly, at least one LEA that previously rejected QZAB funds because of the high administrative burden they imposed is now expressing interest in the FY 2012 funds; this suggests that the potential for increased funding makes the administrative burden of managing a QZAB project worth the effort. It is clear that the larger amount of potential allocation within the \$15.9 million has sparked renewed interest in this program among the LEAs.

Distribution and Administration of Funds: Breakthrough Center and Competitive Grants

We recognize that there is considerable concern among LEAs about the fairness of the method that will be used to distribute the FY 2012 QZAB funds between the Breakthrough Center projects and the competitive grant projects. We believe that given the innovative quality of the funding approach proposed in this legislation, which has no precedent in Maryland or in any other state that we are aware of, it is essential for the Interagency Committee on School Construction to have considerable flexibility to assess project applications for eligibility and educational impact and to confirm the administrative capacity of the applicants to meet the deadlines. Accordingly, we have under consideration certain administrative processes that we believe will ensure an equitable distribution of the funding and assist the recipients in administering their programs:

1. There will be no prohibition against an LEA that receives Breakthrough Center funds from also applying for competitive QZAB grants. The total funding each LEA receives under either program will depend on the quality of their applications, the eligibility, size and urgency of their proposed projects, and the demonstration of internal administrative capacity to meet the timeframes required.
2. We will determine whether progress payments will be allowed. The current method of reimbursing projects after completion was based on the typically small size of the projects funded through prior year allocations (\$115,000 average construction value). We understand that if larger QZAB projects are approved in FY 2012, the current method could impose a fiscal burden on local boards and local governments. Progress payments will also assist the State to achieve the 100% reimbursement deadline sooner, and with greater knowledge of the current status of each project. Weighing against this, however, is the potential administrative burden a progress payment approach will impose on the PSCP, which has experienced a substantial reduction in staffing.
3. For LEAs that receive Breakthrough Center allocations, large allocations under the competitive grant portion, or that have experienced difficulties in the past in placing their projects under contract, we will put in place administrative protocols to monitor project status. Again, the extent to which this will be possible will depend on the PSCP staff resources.

The substantial source of bond proceeds that will result from passage of SB 122 will assist local school districts in Maryland to address their enormous backlog of school facility deficiencies, many of which are suitable for QZAB-funded projects. The proposed method of distributing the funds will assist the Maryland State Department of Education to achieve turnaround goals expressed in its winning application for Race To The Top federal funding. Accordingly, we request the Committee to report favorably on Senate Bill 122 in order to authorize the issuance of the Qualified Zone Academy Bonds for FY 2012.