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# **Capital Budget Overview**

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## **Orientation**

**Prepared by  
Department of Legislative Services  
Office of Policy Analysis**



# Capital Budget Overview

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## Definition of Capital

A capital improvement is a project that has a useful life at least equal to the life expectancy of the bonds sold to finance it (currently 15 years) and costs \$100,000 or more. Examples of capital improvements include:

- real property acquisition;
- architectural and engineering services;
- construction of new facilities or renovation of an existing facility;
- site development and improvements; and
- initial capital equipment.

## What the State Funds through the Capital Budget

Capital projects can be grouped into three categories:

- **State-owned Capital Projects** – the construction of State buildings and infrastructure such as prisons, State hospitals, public university buildings, and State office buildings.
- **State Capital Programs** – programs that provide State financial assistance to local governments and private organizations for the construction of capital projects that serve a public purpose and meet State policy objectives (*e.g.*, public school construction, Chesapeake Bay restoration, local jails, community colleges, housing, health and social programs, and economic development).
- **Capital Grants** – grants for non-State-owned capital projects requested by local governments and private organizations.

## Capital Authorizations in Budget Bills

The authorizations for the State's capital program are contained in multiple bills. Authorization of capital projects can be found in the operating budget bill through pay-as-you go (PAYGO) funding using general, special, federal, or reimbursable funds, which includes the transportation capital program. The primary bill containing authorizations for capital projects and programs is the Maryland Consolidated Capital Bond Loan bill (MCCBL or capital bond

bill). The MCCBL may also contain amendments to prior authorizations or pre-authorizations for future years.

Local bond bills are introduced as separate bills, but selected projects are amended into the MCCBL. The separate pieces of legislation are not passed. The local bond bills are projects initiated by members of the General Assembly to authorize projects in support of local cultural, historic, health, education, and/or economic development. Generally, the authorizations require the recipient to provide matching funds equal to the State funds and to convey an historic easement, if applicable, to the Maryland Historical Trust.

Other authorizations for specific sources of capital programs, such as the qualified zone academy bonds (QZAB) and Academic Revenue Bonds, are not part of the MCCBL and move as separate bills.

### **How the Capital Budget Differs from the Operating Budget**

Unless otherwise provided by law, the authority to spend a capital authorization for a project terminates within two years of the effective date if either a required matching fund has not been presented to the Board of Public Works, or no part of the project is under contract, and the board has not encumbered funds for any part of the project. However, to the extent that the board has encumbered funds for a State project or program authorized by an appropriation act, the authority to spend those funds is extended to seven years from the effective date of the act that authorized the project. Local bond bill projects, at times, have received shorter authorization periods.

Unlike the operating budget, the General Assembly may add as well as delete projects from the capital bond program. Also, the MCCBL is considered a supplementary appropriation bill and as a result cannot be finally acted upon until the operating budget bill has been passed. Similarly, the bills authorizing QZABs and Academic Revenue Bonds cannot be finally acted upon until after the operating budget bill has been finally acted upon (including any conference report).

The capital bond bill must be presented to the Governor for signature, and the Governor has line item veto power. However, the capital bond bill, like regular legislation, can pass into law without the Governor's signature after a certain period of time has passed after presentment.

### **Funds Used to Finance Capital Projects**

The capital budget is funded by debt, through the sale of bonds, and by the use of current funds known as pay-as-you-go (PAYGO).

**PAYGO funding** can be general, special, federal, or reimbursable funds. General fund PAYGO is most often used to fund the State's loan programs due to the private activity

involvement and the federal limitations on the use of tax-exempt debt (5% of any given issue). When available, general funds have been used to fund capital projects. Special fund PAYGO is funded from dedicated taxes, fees, or other sources such as loan repayments. Federal fund PAYGO is grants from the federal governments that are dedicated to specific purposes, such as the construction of National Guard armories and local water and wastewater treatment plants.

The State issues different types of debt. The largest component of State debt is **general obligation (GO) bonds**. GO bonds are backed by the full faith and credit of the State, which agrees to pay principle and interest to bond holders. The bonds are typically issued for 15 years but can be issued in shorter maturities. The State pays the debt service on these bonds from the Annuity Bond Fund. The fund's primary revenue sources are State property tax receipts and general funds. The State issues transportation bonds that are supported by specific taxes and fees dedicated to the Transportation Trust Fund.

The State also authorizes certain agencies (*e.g.*, higher education) to issue **revenue bonds**. The debt service on the bonds is paid from the dedicated revenues generated by the project (*e.g.*, parking fees for a parking garage). Revenue bonds do not constitute a pledge of the full faith and credit of the State.

## How the State Determines Its Affordability Level for Capital Projects

The State's Capital Debt Affordability Committee (CDAC) is required by statute to review the size and condition of State debt and recommend the total amount of new general obligation debt that prudently may be authorized for the next fiscal year. The committee comprises the Treasurer (who serves as the chairman), the Comptroller, the Secretary of Budget and Management, the Secretary of Transportation, one public member, and as nonvoting members, the chair of the Capital Budget Subcommittee of the Senate Budget and Taxation Committee and the chair of the Capital Budget Committee of the House Appropriations Committee. The goal of the committee is to maintain the State's "AAA" bond rating. The committee uses the following two principles as guidelines: (1) total outstanding State tax-supported debt should not exceed 4% of State personal income; and (2) debt service on State tax-supported debt should not exceed 8% of revenues (general fund and property tax).

During the summer months, CDAC meets to analyze the State's debt status. In the fall, CDAC makes recommendations to the Governor and General Assembly as to the maximum amount of new GO debt that should be authorized in the next session.

## How Capital Projects Are Planned

The life cycle of a typical project is four or more years from the time it is requested and approved by the Department of Budget and Management (DBM). The project phases are:

- project program plan development (Part I conceptual and Part II detailed instruction to an architect/engineer);
- preliminary planning with an architect;
- detailed plans;
- construction; and
- capital equipment.

Each agency is required by State law to have a facility master plan that reflects its programmatic objectives. The master plan is to identify and prioritize current and future facility needs. As indicated above, every project requested must also have a program plan or document that provides details on the need for the project, including projections of usage and a detailed description of the proposed project scope and cost estimate. The document also contains an analysis of project alternatives, such as consideration of new versus renovation or phasing the project components. State law requires an approved Part I program plan prior to the expenditure of design funds and an approved Part II program prior to the expenditure of construction funds.

## The Capital Budget Process

The capital budget process is very similar to the operating budget process in that the Executive Branch formulates the capital program.

- Agencies submit their requests for capital improvements to DBM – Office of Capital Budgeting no later than July 1 each year for State-owned projects and August 15 for grant and loan programs. DBM analyzes each request and considers it against the State's capital needs.
- CDAC recommends a debt limit for new GO bonds by October 1. The Governor, in mid-November, prepares a preliminary allocation of the amount of debt to authorize for State-owned facilities and other grants and loans.
- DBM makes its recommendations to the Governor for the capital program in late November. The recommendations include a draft of the *Five-Year Capital Improvement Program* (CIP). This document presents the statewide plan for addressing critical statewide needs for capital improvements.
- In December the Spending Affordability Committee makes an advisory recommendation on the debt limit for new general obligation debt authorization.

- The Maryland Consolidated Capital Bond Loan bill must be introduced by the twentieth day of the session.

### **Legislative Consideration and Action**

The General Assembly approves the authorization of capital projects funded with PAYGO as part of the legislative action taken on the operating budget bill. The same legal constraints apply.

The capital projects funded by GO bonds are considered thereafter in a similar process. Although the legislature is not required to stay within the prescribed debt limit, the practice has been to remain within it. The legislature may add projects to the capital program by reducing or deleting projects from the introduced capital program.

The explanations of the actions of the General Assembly on PAYGO and GO are contained in the *Joint Chairmen's Report* (JCR). However, the PAYGO actions are contained with the operating budget section of the JCR.

### **Budget Implementation**

- The capital budget is effective June 1.
- State projects are managed by the Department of General Services (DGS) with the following exceptions: the University System of Maryland, the Maryland Environmental Service, Morgan State University, the Maryland Department of Transportation, and the Department of Public Safety and Correctional Services. These entities have been given autonomy to manage their own capital projects.
- The Board of Public Works approves most capital expenditures including grants and contracts. For public school construction projects, the board approves the State funding level for projects, but approval of specific contracts encumbering these funds is not required.
- If a PAYGO-authorized capital project is completed and funds remain, those funds typically revert to the Annuity Bond Fund to help pay debt service. If a bond-funded project is completed with a remaining balance, the outstanding authorization is typically but not required to be used in the following manner:
  - Less than \$10,000 – the funds are cancelled.
  - \$10,000 to \$100,000 – the funds are placed in the construction contingency fund.

- Over \$100,000 – the funds are de-authorized.

## The Department of Legislative Services' (DLS) Role

### During the Interim

- Respond to legislative requests.
- Prepare special reports as needed.
- Complete an independent review of the CDAC report and present the findings to the Spending Affordability Committee (report titled *Effect of Long-term Debt on the Financial Condition of the State*).

### During Session

- Prepare and present capital analyses for each project with recommendations to approve, reduce, restrict, or deny funding.
- Support committee decisions/floor debate/and process the capital budget bills.
- Prepare summary material. The JCR explains the actions taken on the operating and capital budgets.

### Useful Documents and Publications

*Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations* – The statutory committee meets to review annually the size and condition of the State's debt and to establish an estimate of the maximum amount of new general obligation debt and academic revenue bonds that prudently may be authorized. The report presents the recommendation and the affordability analysis.

*Effect of Long-term Debt on the Financial Condition of the State* – Prepared in November by DLS, this report provides a review of the recommendation and an independent analysis of the Capital Debt Affordability Committee report.

*Five-year Capital Improvement Program* (CIP, also known as the Capital Budget Volume of the Governor's Budget) – Published by the Executive Branch, this volume accompanies the capital budget bill in January. The volume provides a description of each capital project and program proposed in the five-year capital improvement program.



*Analysis of the Capital Budget* – Prepared by DLS during the legislative session, it contains a copy of the Capital Overview and all capital analyses.

*Capital Committee Report* – A summary of amendments to the capital budget bill that explains each action. Narrative expressing the policy intent of the budget committees is also included. DLS prepares versions of the committee report for each house to support the capital budget debate in March. Following the Conference Committee, the JCR is published in April including action on the operating budget.

*The 90 Day Report* – Prepared by DLS at the end of session, this report summarizes the actions of the legislature during the session, including a summary of the capital budget.

*Capital Improvements Authorized by the General Assembly* – Published by the Executive Branch in July, this report provides a summary of all State-owned and non-State-owned capital improvement projects and programs authorized by the General Assembly for certain years, except for those of the Department of Transportation.