MARYLAND DEPARTMENT OF THE ENVIRONMENT

2007 FISCAL ANALYSIS PROJECT

NOVEMBER 2007

Martin O'Malley
Governor

Anthony G. Brown
Lieutenant Governor

Shari T. Wilson
Secretary

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Deputy Secretary

MDE 2007 Fiscal Analysis Project

The Maryland Department of the Environment (MDE) is the State regulatory agency charged with protecting public health and the environment and restoring the quality of Maryland's air, water and land through regulatory, planning and financing programs. For fiscal 2008, MDE is budgeted for 990 permanent and contractual employees, with an operating budget of $113 million, including $5 million for revenue bond debt service, and a capital budget of $233 million.

The demand on MDE's programs has increased annually. From 1990 to 2000, for example, impervious surfaces in Maryland increased by 41%, reflecting the pace of construction and impacts on the environment. This land conversion correlates directly with increased regulatory mandates for MDE in the form of increased permitting and compliance monitoring for activities such as stormwater runoff, wetlands, drinking water supply, sewage treatment and air quality.

New federal and state mandates have also been added annually, while funding and personnel allotments over the past several years have not kept pace with inflation or workload increases. For example, in 2006, a statutory change requires county comprehensive plans to include water supply, wastewater capacities, and water quality requirements as part of land use plans. Implementing this new function required four new positions, although none were provided through the budget process. This scenario has been repeated many times over the past ten years.

The purpose of this fiscal analysis is to provide a financial prognosis on which to base future policy, programmatic and budgetary decisions, including risk-based prioritization of activities, elimination of low risk functions, reallocation of existing resources, and options for additional revenue.

This fiscal analysis was conducted by a Steering Committee appointed by Secretary Shari T. Wilson:

Chair: Jag Khuman, MDE Water Quality Financing Administration Director

Members:
The Honorable Murray Levy, Maryland General Assembly
Eric Christensen, Maryland Department of Transportation
Heather Barthel, MDE Legislative and Policy Director
Richard Eskin, Ph.D., MDE Science Services Administration Director
Terri Wilson, MDE Budget & Financing Director

Message from the Secretary

The Maryland Department of the Environment is extremely appreciative of the commitment of the Steering Committee in undertaking and completing this study. Each member enthusiastically agreed to participate despite other full-time workloads. The Department is particularly grateful for Delegate Levy and Eric Christensen's participation. Their interest and commitment to public health and the environment is ably demonstrated by their commitment of time and expertise to this endeavor. We would also like to thank Governor O'Malley's Transition Team who so clearly focused on this critical issue in its assessment of the Department. This objective analysis will serve as a baseline for future decision-making at the Department as we move forward to ensure that the agency's financial resources and staff expertise are used as efficiently as possible to meets its mandates to protect public health and the environment.

Sincerely,

Shari T. Wilson
Secretary

MDE 2007 Fiscal Analysis Project

Executive Summary

This analysis, the first of three phases, is an objective summary of prior year revenues and expenditures, identification of cost, workload, and revenue trends, and a forecast of fiscal impacts if no revenue changes are made. The next phase, which began in August 2007, is an analysis of how existing resources within MDE can be reallocated to meet the highest priorities. The third phase will identify policy and programmatic changes to address any remaining shortfalls.

MDE programs rely on a combination of general, special, federal and reimbursable funds to support activities. Due to increasing federal and state mandates, increases in salary and fringe benefit costs, and reductions in State general funds available for environmental programs over the past several years, MDE programs are increasingly dependent on non-general funds to support daily operations. As a result, special and federal fund expenditures are increasing faster than total revenues, which are insufficient for MDE to support all regulatory mandates and critical programs and activities. For example, MDE receives federal funds for programs, such as Air Pollution Control, that are delegated to the State. The federal grant funds have not increased at the same pace as MDE's operating/personnel costs, and although these costs are often supplemented with State general funds, those general funds have also not kept pace. Similarly, MDE has over 30 dedicated-purpose special fund sources, along with the statutory authority to establish and collect fees to support certain activities. However, there is no mechanism currently in place that allows for periodic fee adjustments to keep revenue in line with inflation or workload increases.

This report identifies a key problem. Given the fact that revenues have not kept pace with non-discretionary and other costs outlined above, the agency is increasingly reliant on special fund balances – most of which are decreasing. If changes are not made, the agency will have to reduce full-time equivalent staff (FTEs) by 44 per year beginning in FY2009. This reduction would be the equivalent of eliminating one large regulatory program annually.

Given the fiscal forecast identified by this report, MDE must prioritize allocation of resources to activities that provide the greatest environmental benefit and public health protection, while reducing or eliminating low risk, low benefit activities through administrative, regulatory or legislative changes. MDE needs to evaluate options for revenue enhancement, with the goal of fully supporting program costs. To accomplish this, MDE's senior management is identifying activities and mandates that are the highest priority in order to allocate adequate resources to these critical functions in the future.

MDE 2007 Fiscal Analysis Project

In reviewing MDE's historic financial and programmatic data, the steering committee makes the following key observations:

1. Regulatory Compliance:

- Regulated sites that require MDE inspection monitoring have increased from 170,000 to 198,000 from FY 2003 to FY 2006 (Figure 1).
- Inspection coverage (% of regulated sites inspected) has increased from 19% to 28% between FY 2003 and FY 2006 (Figure 2), despite a decrease in the number of full-time equivalent positions (FTE) allocated for inspections from 156 to 139, indicating increased productivity as MDE is doing more with less (Figure 3).
- MDE issues 64 different types of permits and licenses for the three regulatory areas of Water, Air and Waste Management, of which 39 require fees, while 28 do not.
- The total number of permits and renewals averaged 24,250 per year between FY 2003 and FY 2006.

Figure 1.

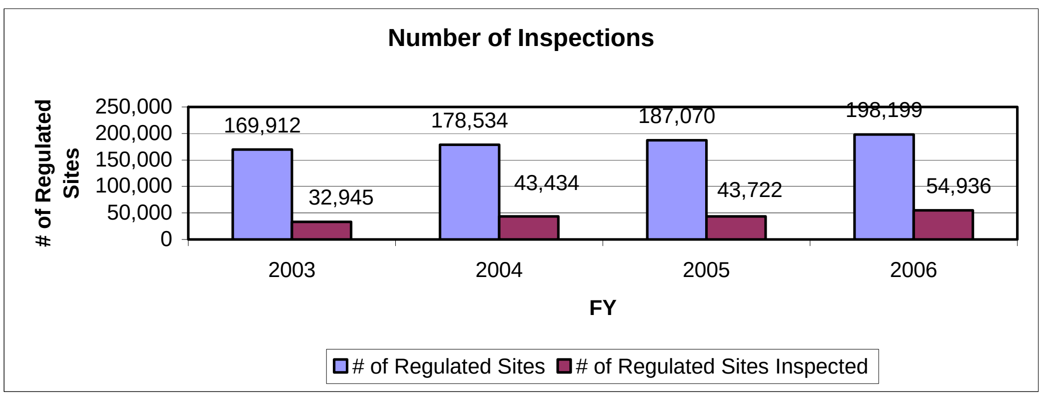


Figure 2.

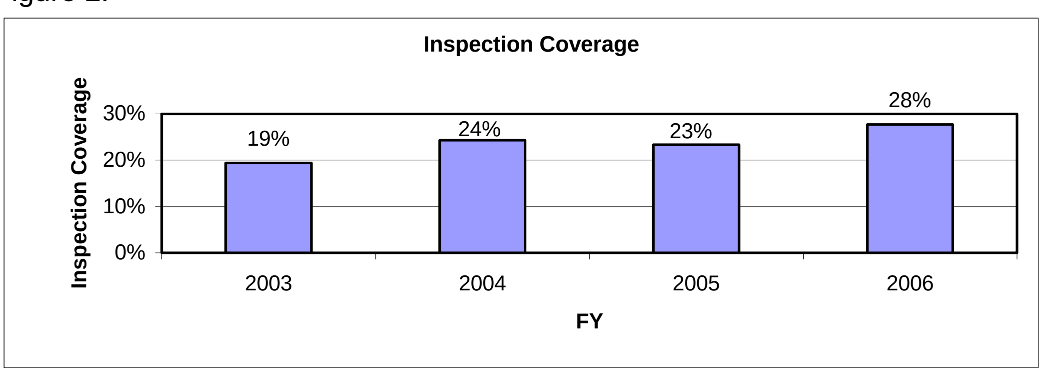
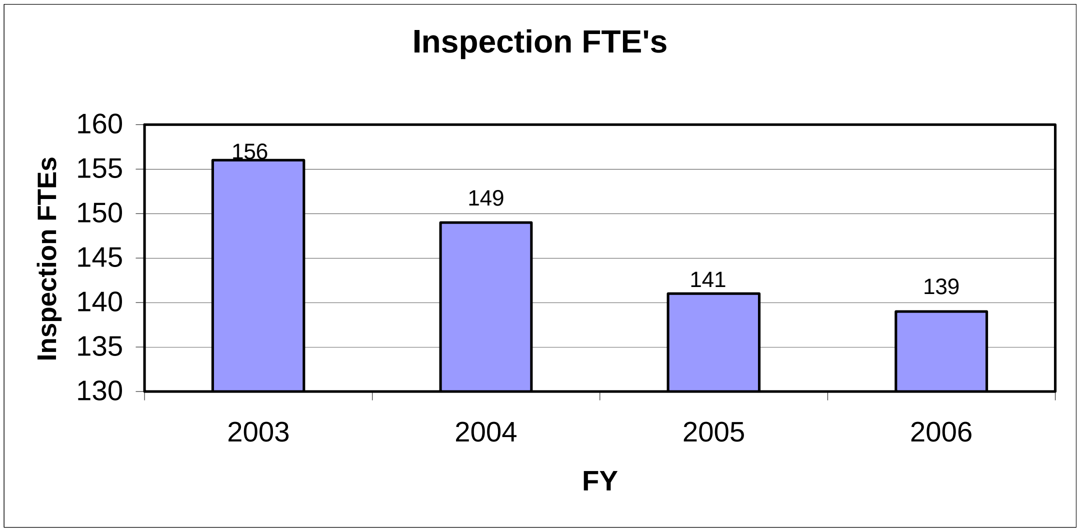


Figure 3.



<u>Analysis</u>

MDE's ability to protect Maryland citizens from unacceptable risk to public health and environmental harm through inspections and regulatory compliance monitoring is one of MDE's core responsibilities. From 2003 to 2006, the number of regulated sites increased by 17% while the staff allocation for compliance inspections declined by 11%. Over the years, MDE has created efficiencies by cross-training inspectors and streamlining procedures, which increased the percentage of regulated sites inspected from 19% to 28%. However, this pace is clearly not sustainable over the long-term with existing resources. MDE has taken a risk-based approach to prioritizing inspection activity (and is currently increasing reliance on risk-based activities), but with reduced monitoring, there is an overall increase in risk of environmental impacts.

2. Funding and Staffing:

- The number of FTEs declined from 1,062 in FY 2002 (Figure 4) to 990 in FY 2008, while regulatory mandates, such as number of regulated sites, complexity of permit application reviews, and public controversies regarding regulatory decisions continue to grow.

- Staffing allocations are based on State budget constraints and statewide guidance regarding limitations on new positions, and not on actual programmatic needs, even when sufficient federal or special revenues are available. This position allocation methodology results in immediate resource constraints and long-term issues such as maintaining long-term contractual employees in positions that should be permanent. This, in turn, increases employee turnover, reduces efficiency and creates an inequitable situation.

- Salary expenses (wages and fringe benefit costs) per FTE are increasing at more than 4% per year (Figure 5), consistent with other State agencies. These increases are largely due to statewide cost-of-living adjustments, length of service salary increments and employee health insurance subsidy costs.

- Based on the current trend of increasing cost/FTE, MDE's salary budget would need to increase by $3 million per year to maintain the current level of staffing (Figure 6).

- If MDE operating revenue does not increase to cover the increasing personnel costs, staffing levels are projected to decline from 990 FTEs in FY 2008 (945 permanent and 45 contractual positions) to 814 FTEs by FY 2012, an average reduction of 44 FTEs per year (Figure 7). This is equivalent to one major MDE program function being eliminated annually, beginning in FY 2009.

Figure 4.

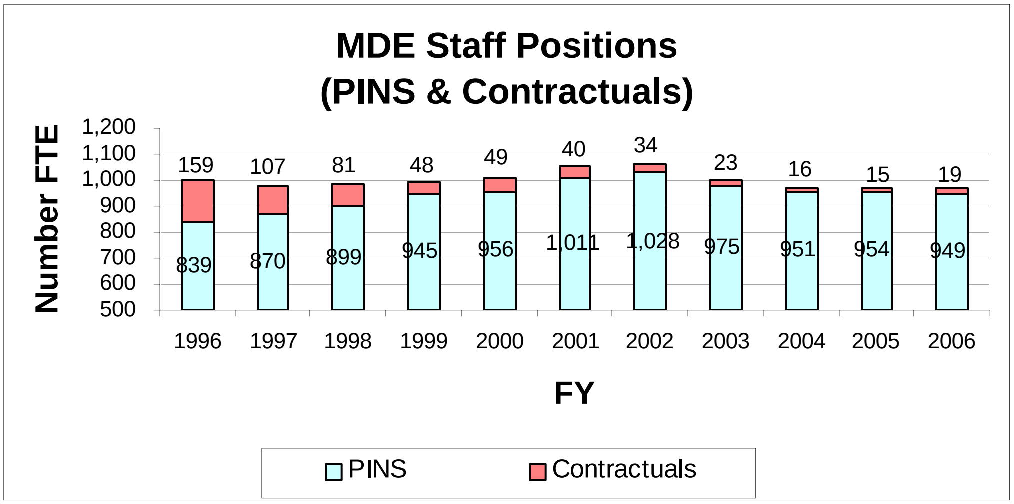


Figure 5.

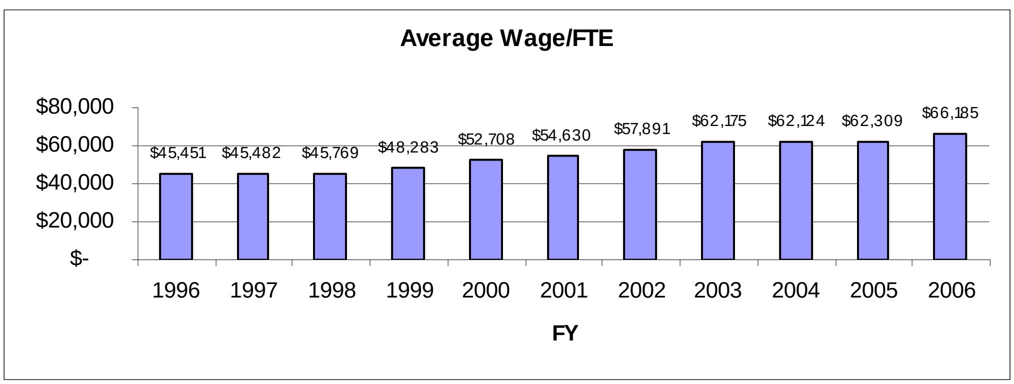


Figure 6.

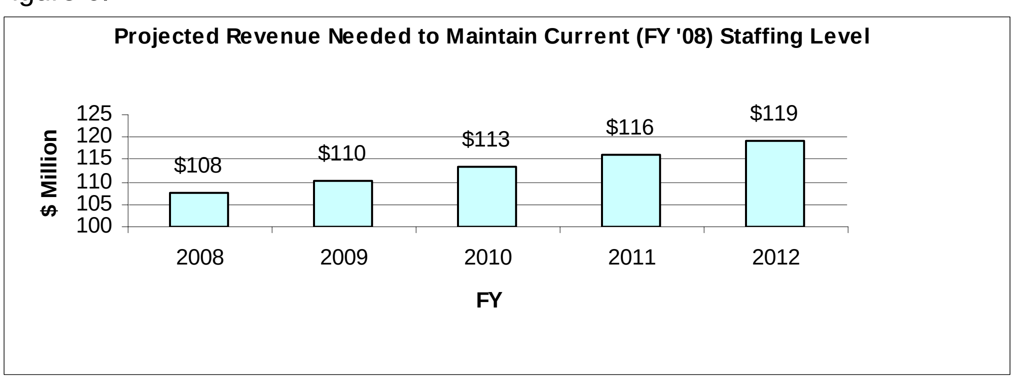
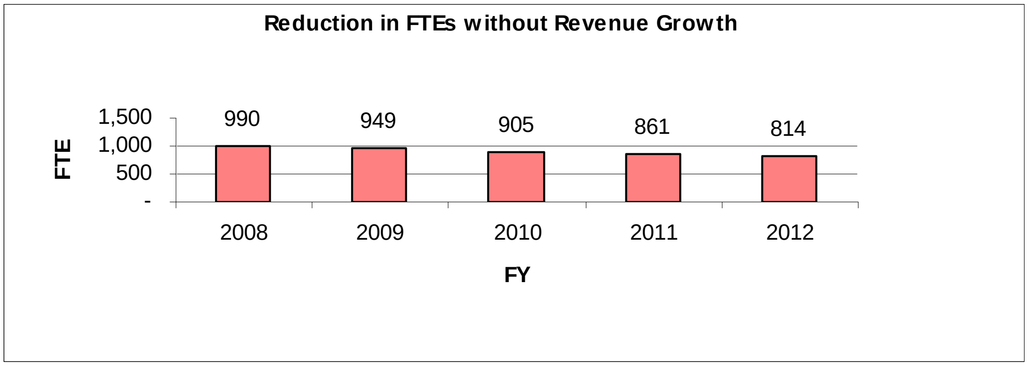


Figure 7.



<u>Analysis</u>
Adequate staffing levels are a critical component to enable MDE to fulfill its mission. These projections quantify the funding that will be required to maintain the current level of staffing, or the rate at which that level of staffing will have to be reduced if funding is not increased in some manner. It does not factor in the additional staffing currently needed for MDE to meet its existing statutory requirements and assumes that salaries and fringe benefits will continue to increase at the 4.5% annual historic growth rate.

It is also important to note that (1) certain federal grants require that a baseline level of effort be maintained, and if MDE falls below that level, the agency risks the loss of federal funds; (2) the current staffing level is not adequate to meet water quality goals as illustrated by the number of impaired waters in Maryland; and (3) federal and state mandates keep increasing, often without adequate staffing or funding to support these new requirements.

Example: Increased State Mandate without Adequate Additional Staffing

The Bay Restoration Fund (BRF) Act, enacted in 2004, generates $66 million per year from fees to be used for capital project grants for nutrient reduction to the Chesapeake Bay. Approximately $1.45 million per year of BRF special fund revenue is available to MDE for BRF operating expenses. The fiscal note included 17 new positions for MDE. To date, MDE has received four new positions through the State budget process for this program, significantly less than the number provided for in the fiscal note, even though adequate special fund revenue is available. As a result, existing staff and/or existing vacant PINs have been reassigned to perform the work associated with this program, resulting reduced in staffing and related efforts in other critical programs.

3. Sources of Funds

- MDE’s operating budget relies on a combination of General, Federal, and Special funds, with modest support from Reimbursable funds. Overall MDE’s budget has not kept up with inflation in recent years (Figure 9).

- MDE has limited control over fixed costs such as salaries and fringe benefits, rent, utilities, fuel, and debt service.

- General funds have declined, from a peak of $45 million in FY 2002 to $34 million in FY 2006, and the gap has been offset primarily by increased Special fund expenditures (Figure 9).

- Figure 10 shows the cumulative year-over-year MDE expenditure increase, compared to the average rate of increase of 4.5% per year, which indicates that:

  - Federal funds did not keep up with the rate of increase;
  - General funds kept up with the rate of increase through FY 2004 but have declined nearly 25% since then; and
  - Special funds filled the shortfall by spending down of fund balances - a trend that is not sustainable.

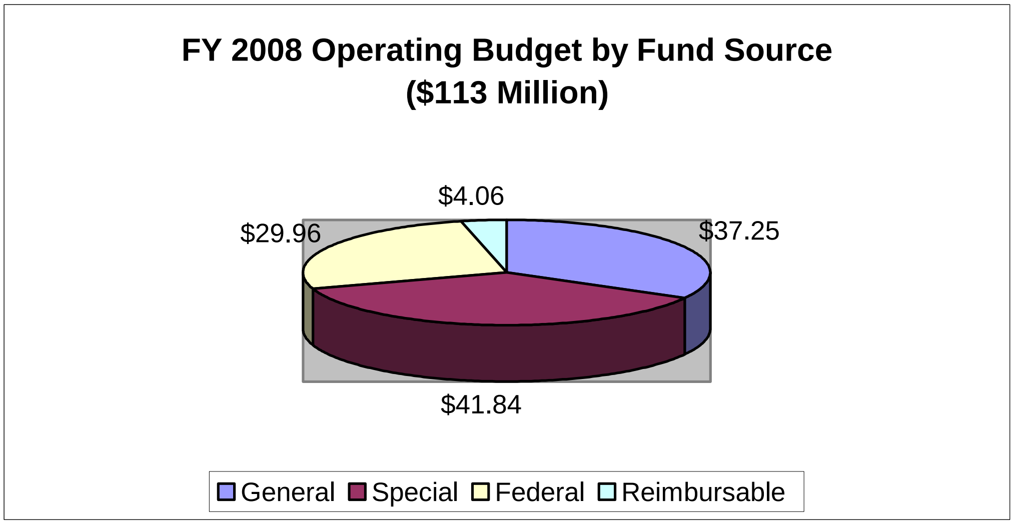
- MDE has over 50 different fees that are collected and deposited into 35 dedicated-purpose special funds. Allowable uses of the special funds, such as the Clean Water Fund, the Clean Air Fund, and the State Hazardous Substance Control Fund, are restricted by statute. These statutory restrictions limit MDE's ability to meet its highest priorities that change over time. For example, the Used Tire Cleanup and Recycling Fund generates sufficient revenue on an annual basis to meet program requirements, while other waste management programs, such as the Solid Waste Program, are dependent on general funds and are understaffed as a result.

- During Fiscal 2006, revenue collected in 14 of the 35 special funds was not sufficient to cover operating expenses. As a result, the Department was required to spend prior year fund balances to address the shortfall in revenues. For example, the Air (Title V) operating permit fund, Hazardous Substance Control Fund and Bituminous Coal Open-pit Mining Fund, each had an annual FY 2006 deficit greater than $300,000.

- Many of the fees collected to support the special funded programs have not been increased over the course of time and cannot be adjusted to reflect workload increases and inflation without statutory changes. For example, the Industrial Discharge Permit fee under the Clean Water Fund have not been raised since 1993, and several permit fees in the Mining Program have not been increased since the 1970's.

- Several special funds have a cap on the amount of money that may accumulate in the fund, such as the $750,000 limit on the Clean Air Fund. Any balance that exceeds the cap reverts to the General Fund. The cap hampers MDE's ability to access the Special Funds for the purposes for which the funds are collected – to operate air pollution control programs.

Figure 8.



Special Funds include $5 million related to bond Debt Service

Figure 9.

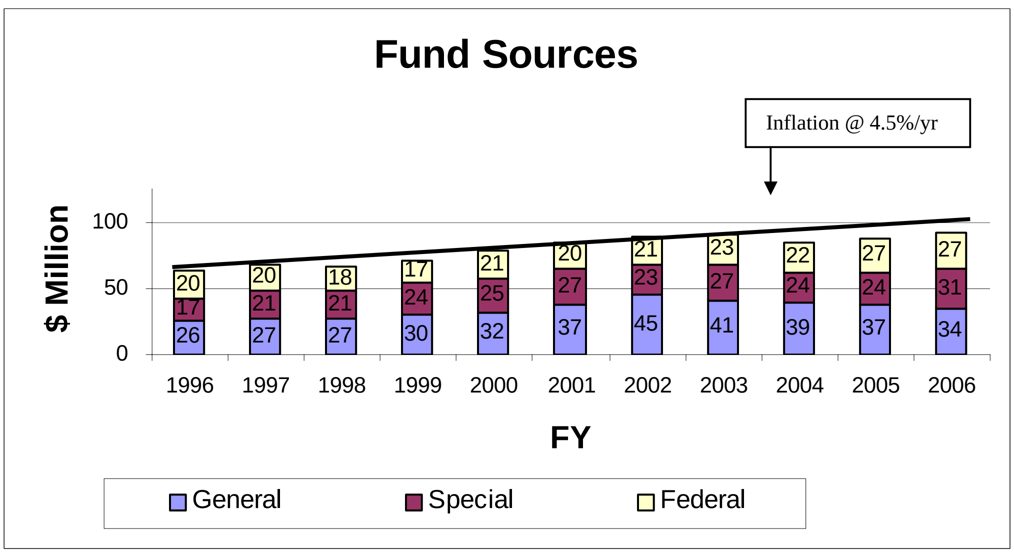
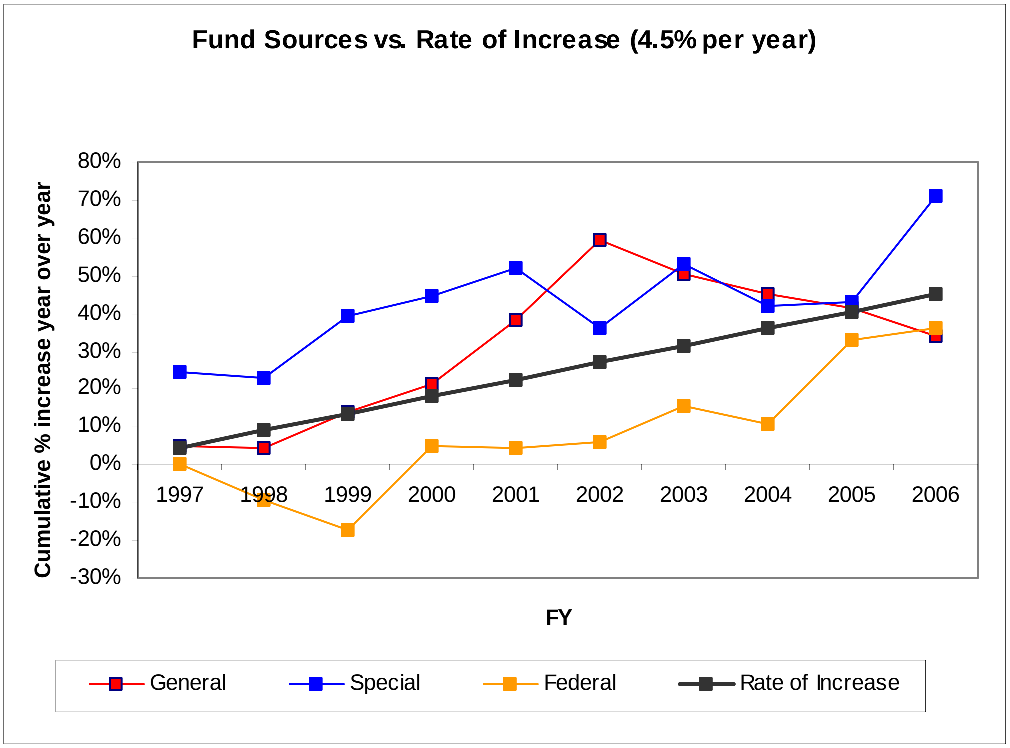


Figure 10.



FY 2006 Special Fund increase is primarily due to higher expenditures in the Clean Water Fund, Tire Fund, Revolving Loan Fund and Department's Indirect Cost recovery.

<u>Analysis</u>

Although MDE is active in applying for additional federal funds through competitive grants,[1] federal grants fulfill only a portion of the total needs, and typically require some level of matching funds.

Special fund revenues contribute significantly to the Department's ability to address specific environmental and public health issues. However, the Department's inability to adjust fees without statutory changes to address workload increases and inflation significantly hampers its efforts to meet its mandates. In addition, because most fees have not been updated to keep up with the true cost of the activity, the number of special funds showing annual deficits is increasing.

Conclusions

MDE's revenues have not kept up with the rate of inflation and new requirements and are currently inadequate to fulfill the Department's mandates despite significant and documented productivity gains. Adding to the gap between revenues and inflation-adjusted needs, are the cost associated with rapidly increasing federal and state mandates, the complexity of regulatory issues, and the increasing numbers of regulated entities, which are growing faster than inflation. Caps and inflexible limits on spending of special funds, the inability to adjust fees for increasing actual costs and the inability to fill positions or receive new positions even when special funds are available exacerbate the challenge.

[1] According to the Governor's Grants Office Annual Report, MDE ranks 7th among State agencies in of federal grant funds received and 3rd highest in number of grants received.

MDE has not been successful in recent attempts to increase certain special fund revenues through the legislative process. Therefore policy decisions need to be made regarding the following:

1. Reduce MDE's core mission based on available revenue, recognizing the loss of positions, and accept the increased risk to environmental protection and to public health;
2. Seek additional State general funds to meet the programmatic needs or at a minimum provide for MDE's increased staffing costs;
3. Ensure that fees and other revenues are adequate to fully fund mission-critical programs. Where applicable, legislative or regulatory changes should be made to allow periodic adjustment of special fees to account for inflation and workload adjustments, so that revenues can support the actual cost of the activity.
4. To enable the Department to address the highest environmental and public health priorities, the number of single-purpose special funds could be reduced, with a concurrent expansion in the eligible use of these funds. For example, revenues currently deposited into the Sediment Control Fund could be redirected to the Maryland Clean Water Fund, and its statutory uses could be expanded to include administration of the Sediment Control Program. This revenue-neutral approach would be very helpful, but not a complete solution to these challenges facing the Department.
5. The cap limit on the Special Funds could be removed so that the revenues collected are retained within MDE and made available to support critical environmental and public health activities. Four funds currently have statutory caps, which require that excess revenues be transferred to the General Fund rather than being retained for the environmental programs that generate the revenues.

These options are not exclusive of each other and there may be other options that could be considered.