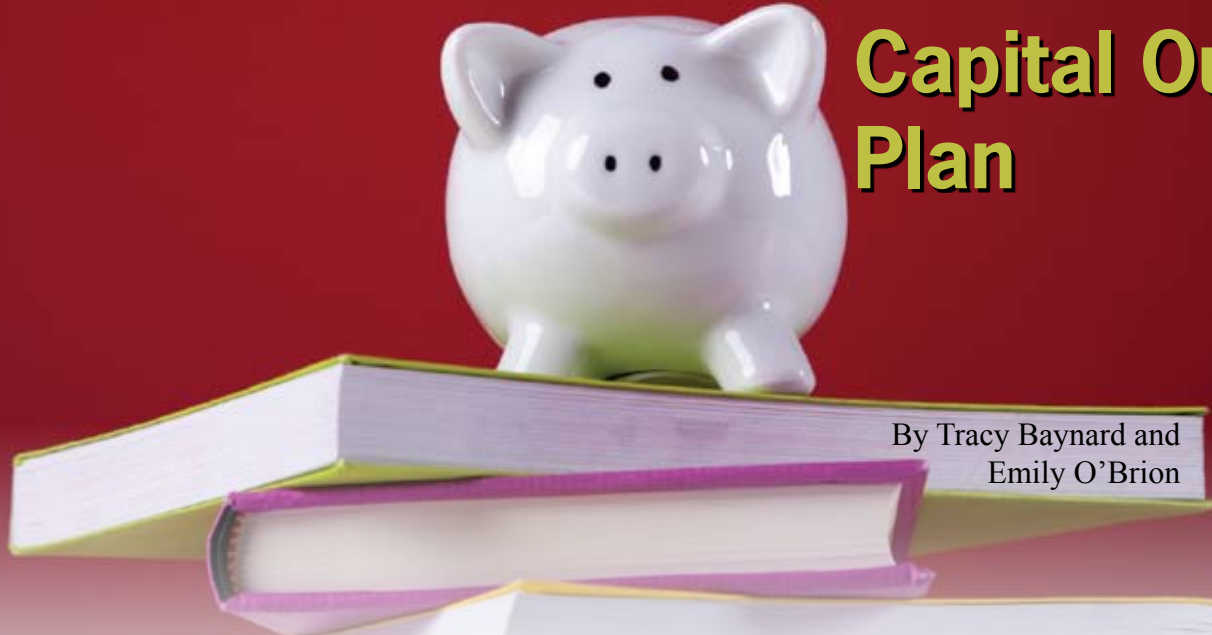


Challenges and Opportunities

for Virginia's Higher Education

Capital Outlay Plan



By Tracy Baynard and
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The current 2008-2010 biennium budget for Virginia ends June 30, 2010. The Commonwealth's constitution requires the budget be balanced, and according to existing analysis projections, Governor Kaine and the General Assembly will have to cut \$1.35 billion from estimated spending for the remainder of the biennium in order to balance the budget.

In previous recessions the impact of such dramatic reductions in state resources would have had a predictable impact on higher education capital project funding. When in need of revenue to balance the budget and maintain state operations, cash identified for capital projects but not yet spent would be swept back in to the general fund for other uses. If bonds had not been issued for a project, the issuance of bonds was delayed until revenue collections increased to provide sufficient debt service. The structure for funding higher education and other public agency capital projects made this easy.

For decades higher education capital projects were funded with cash, sustaining Virginia's tradition of pay-as-you-go and reluctance to use debt. As the state's population began to grow rapidly, efforts to maintain the quality of higher education convinced the decision-makers that Virginia would not lose its valued AAA credit rating if it issued bonds to upgrade facilities for students. This ushered in a period of statewide bond referendums every seven to ten years to pay for capital projects at the state's public institutions

of higher learning. The referendums were always approved by the general public with large margins and the debt service came out of the general fund.

The challenges with his funding process did not end at making capital projects easy targets from which to divert funding by slowing issuance of the bonds. The projects were funded in one lump sum as identified in the bond referendum language. Because the projects were pre-determined but implemented over an extended timeframe, there was little or no practical flexibility for institutions that changed their mission or focus. The long period of time between planning and construction often meant a project's cost had increased by the time a construction RFP was issued. This became especially noticeable during times of national or global prosperity when competition for labor and materials drove up costs of construction. Cost increases not covered by the planned bond funding required the institution to return to the General Assembly to get additional funding; the process was not always successful and sometimes conflicted with funding requests for an institution's current operational needs.

The Six-Year Capital Outlay Plan

Urged by Virginia's business community, in 2008, Governor Kaine and the General Assembly enacted legislation that significantly

changed the capital project funding process. During a special session the legislature established a system for funding capital projects through a new Six-Year Capital Outlay Plan (the Capital Outlay Plan). The law is intended to enhance long-term planning by improving the accuracy of construction cost estimates, reducing cost overruns, and providing greater flexibility to agencies and institutions of higher education.

The process outlined in law creates a Six-Year Capital Outlay Plan Advisory Committee to assist in the development of the Commonwealth's Capital Outlay Plan. The advisory committee, comprised of several agency heads including the executive director of the State Council of Higher Education for Virginia, is charged with reviewing all agency and public higher education capital requests and making recommendations to the Governor and General Assembly. Each year before the start of the legislative session, after considering the advisory committee's recommendations, the governor is required to submit to the General Assembly a bill containing the Six-Year Capital Outlay Plan. This contains a list of capital projects to be considered for funding entirely or partially from the general fund over the next six fiscal years.

The first six-year plan enacted under the new system, Chapter 46/Chapter 696, 2009 Acts of Assembly, included previously authorized capital projects as well as new projects; each subsequent plan building on and amending the previous one. Capital projects included in the six-year plan are ranked by agency priority and are divided into categories based on cost estimates.

In the past, capital projects received full funding, often through large bond referendums that took place once or twice per decade. In the new capital planning process, projects receive funding in three phases including pre-planning, detailed planning, and construction. Pre-planning involves

obtaining a detailed project definition and total cost estimate, including site and program execution option analysis. Institutions may be awarded \$250,000, or one percent of the project construction costs, whichever is less, for pre-planning. Detailed planning involves the preparation of architectural and engineering documents up to the preliminary design stage. Construction is defined as the preparation of final working drawings and specifications, advertising for bid, awarding of a contract, and the actual construction or renovation of a project. Projects will generally be considered for construction phase funding only after they have cleared the first two phases in the process.

The new phased system is expected to improve the capital planning process. A project will undergo pre-planning and detailed planning before it can be authorized for construction, increasing the likelihood that a discovery that could lead to increased costs or otherwise impact the project, will be made prior to requests for construction funds. Agencies or institutions unable to secure non-general fund sources for a project that exceeds 105 percent of its proposed general fund budget will be required to reduce the size or scope of the project. They will also have the opportunity to modify cost estimates during the planning process. The separate planning stages should also cut down the time period between a project's authorization for construction and the start of construction.

What the Recession Means for the Capital Outlay Plan

The current fiscal challenges in the Commonwealth are the first under this new capital project funding scheme; so how will the Governor and the General Assembly respond to the Capital Outlay Plan? First priority will be given to fully funding existing contracts already permitted with work underway; the Commonwealth is not known for withdrawing funds from work in process.

- Institutions are likely to seek permission to use their own, or their foundations' funds to move projects from pre-planning to planning stages. The provisions of the Capital Outlay Plan allow institutions to use their own money for pre-planning and planning activities and to seek reimbursement from the state as part of any allocation for construction approved in the future.
- The State Council of Higher Education for Virginia and the Virginia Community College System will challenge individual institutions to look for efficiencies and focus requests on those facilities that most address classroom, laboratory and student housing needs.
- For the first time, some institutions will either expand or entertain the use of innovative procurement tools; including design-build, construction management at-risk and the Virginia's Public-Private Educational Facilities and Infrastructure Act (PPEA Act), as a means of attracting private financing and risk sharing to appropriate projects on their campuses.
- Institutions and the construction industry will make the case that in today's economic environment, drastically cutting capital spending undermines the industry's efforts to recover. Many institutions have examples of the more competitive marketplace that is driving bids to come in below initial budget projections, leaving it up to decision-makers to see the potential to take advantage of bargains and stretch limited dollars further while providing a stimulus to Virginia's construction industry.
- Both candidates for the office of Governor had platforms that called special attention to Virginia's higher education system; both seeing construction as an opportunity to jump-start local and regional economies.

The wild card that could pump additional money into Virginia's community college system for capital projects is President Obama's new higher education initiative that right now would provide \$2.5 billion in capital funds. The funds are distributed to states based on their share of the nation's community college student population poising Virginia to greatly benefit if Congress approves the program as currently outlined. The capital funding is currently identified for:

- Reducing financing costs of loans for construction and modernization, such as paying interest.
- Providing matching funds for a community college capital campaign to attract private donations.
- Capitalizing a revolving loan fund.

The possibility of federal funding being available in fiscal year 2011 is likely to influence the level of state funding to get projects ready to move quickly securing Virginia's share of the funds awarded.

Virginia's higher education Capital Outlay Plan is certainly vulnerable to significant cuts as elected officials seek to balance a state budget that is still seeing revenue collection levels retreat from earlier projected levels; however, the most significant factors that should help minimize the level of cuts are:

- Institutions are reporting bids for both design and construction anywhere from five to 20 percent below projections
- Elected officials are seeing favorable interest rates and if possible are going out into the market to sell bonds; note the number of local and state authorities that are refinancing debt.
- Keeping projects moving forward allows elected officials to save or create new jobs in the construction industry, particularly hit by the recession
- Spending money today on planning and design activities will better position

Virginia community colleges to take advantage of possible federal funding for capital projects in fiscal year 2011.

Governor Kaine will provide the first indication of how the Six-Year Capital Outlay Plan will be treated in the upcoming 2010-2012 biennium when he releases his budget plan December 18. His budget will then be reviewed and revised by the incoming governor and the General Assembly in the



sixty-day legislative session that begins January 13, 2010.



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