

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES**

Agenda Item Summary Sheet

Name: Finance and Facilities Committee

Date: June 17, 2015

Title: FY2016-FY2020 Capital Budget Proposal (Second Reading)

Purpose (check one):

- | | | |
|---|--|---|
| <input type="checkbox"/> Proposed
New Policy or
Amendment to
Existing Policy | <input checked="" type="checkbox"/> Approvals
Required by
Policy | <input type="checkbox"/> Other
Approvals |
| <input type="checkbox"/> Monitoring /
Compliance | <input type="checkbox"/> Information | |

Brief Description:

The report seeks committee and Board of Trustees approval of the FY2016 – FY2020 priorities for capital bonding for submission to the governor and the Minnesota House of Representatives and Senate as a part of the 2016 legislative session, consistent with Policy 6.5, Capital Program Planning.

The report has been modified since the first reading to incorporate answers to trustee questions concerning construction cost management.

Scheduled Presenter(s):

Brian Yolitz, Associate Vice Chancellor for Facilities

**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES**

BOARD ACTION

FY2016-FY2020 Capital Budget Proposal (Second Reading)

PURPOSE

To obtain the Board of Trustees approval of the priorities for capital bonding for submission to the governor and the Minnesota House of Representatives and Senate as a part of the 2016 legislative session, consistent with Policy 6.5, Capital Program Planning.

BACKGROUND

The system's 54 college and university campuses include about 28.0 million square feet of facility space. Of this total, 22.4 million square feet is academic space and eligible for general obligation bonding through the state of Minnesota's capital bonding process. The remaining 5.6 million square feet of facility space is attributable to the revenue fund and include residence halls, student unions, dining facilities and parking ramps. Revenue fund facilities are maintained, improved and constructed through user fees and the sale of revenue fund bonds.

All colleges and universities develop and maintain comprehensive facility plans that take into account academic programming, demographic and enrollment trends, facility condition, configuration, space utilization and energy consumption data. These plans identify and prioritize institutional investment needs for both the academic and revenue fund facility spaces along with any real estate matters.

In March, 2014, the board approved capital guidelines for both the 2016 capital budget and the 2015 revenue fund programs: <http://www.mnscu.edu/board/materials/2014/march19/fin-03-guidelines.pdf>. Taking into account the Strategic Framework and the six recommendations in Charting the Future, the board guidelines sought to focus on projects meeting the following priorities:

1. Strategic regional and statewide academic program focus
2. "Taking care of what we have"
3. Minimizing new square footage
4. Building for the future with flexible and adaptive space

The guidelines also established a total 2016 capital bonding target for the legislative request of between \$250-\$285 million.

Given this guidance, colleges and universities reviewed their comprehensive facility plans and forwarded their prioritized capital bonding requirements for their academic spaces. These

submittals included over \$350 million in asset preservation priorities to be included in the system's Higher Education Asset Preservation and Replacement (HEAPR) program, and nearly 40 capital projects totaling over \$250 million.

In early January 2015, more than 100 academic, finance, facilities and technology faculty and staff from our colleges and universities and the system office reviewed and scored proposed capital projects against the board guidelines. This scoring process included projects that were approved by the board as part of the 2014 process but not fully funded in the 2014 capital bonding bill. Results of that scoring informed the DRAFT recommended 2016 capital bonding priorities at **Attachment A**.

NOTE: In October 2014, the board approved a capital bonding recommendation for the 2015 legislative session, an 'off' bonding year, made up of those 1) projects approved by the board previously, but not funded during the 2014 legislative session, and 2) the construction phases of board approved projects that were funded for design in 2014. Final results of the 2015 legislative session and action on capital bonding are not known at the time of this report. **The DRAFT recommended 2016 capital bonding priorities at Attachment A assumes no capital bonding in 2015.** Final results of the 2015 session will impact the final 2016 recommendation and that impact will be provided to the board as soon fully understood and incorporated.

DRAFT RECOMMENDED 2016 CAPITAL BONDING PRIORITIES

The DRAFT recommendation totals \$286.8 million and would provide \$110 million for asset preservation through HEAPR and \$176.8 million for 22 capital projects at 21 college and university campuses as well as a provision for a potential capital investment in support of the metropolitan area baccalaureate plan.

Asset preservation through HEAPR is recommended as the highest priority and is in keeping with the stewardship charge in the board guidelines. This level of investment seeks to reduce the backlog of maintenance in our academic spaces is currently estimated to be \$740 million and future repair and renewal needs in the coming 5 years is estimated at \$450 million.

Of the recommended projects, eight (8) were board approved, but not funded in 2014/2015 (\$41.6M); five (5) were board approved and the first phases of work were funded in a 2014 bonding bill (\$89.6M); there are nine (9) new projects totaling \$35.6 million and \$10 million to support the metropolitan area baccalaureate plan as that matures in the coming months.

If fully funded the DRAFT recommended 2016 capital bonding program would reduce the system's total square footage by over 60,000 square feet.

CAPITAL BONDING AND DEBT

The system is responsible for one-third of the debt service for its capital bonding projects. This portion of debt is shared equally between the college/university receiving the improved facility and the system as a whole. The state covers the total debt service cost of HEAPR funding.

As of the 2014 financial statements, the total general obligation principal outstanding for system capital bonding projects was \$232 million and the total debt service payment in fiscal

year 2015 was \$31.7 million. If the DRAFT recommended 2016 program was fully funded, the system's total general obligation bond obligation would increase by \$58.9 million and annual debt service payments would increase by \$3.5 million. For debt capacity and debt burden calculations over time, see **Attachment B**.

HISTORICAL PERSPECTIVE

Since 2006, on average, the board has approved a total capital bonding program of \$318.5 million in even or 'on' capital bonding years. In those same years, the system has received on average \$164.7 million, or just over 50% of the requested capital bonding program.

TABLE 1: Total Capital Program Requested and Funded

Year	Total Requested Program	Total Received Program	% Received
2006	\$280.4	\$191.4	68%
2007	\$33.8	\$0.0	0%
2008	\$350.2	\$234.2	67%
2009	\$117.1	\$40.0	34%
2010	\$396.8	\$106.2	27%
2011	\$279.8	\$131.6	47%
2012	\$278.7	\$132.1	47%
2013	\$151.4	\$0.0	0%
2014	\$286.5	\$159.8	56%
2015	\$198.5	TBD	TBD
2016	\$286.8		

In terms of asset preservation, the board has consistently sought \$110 million in HEAPR funding in traditional even numbered capital bonding years to address the backlog of maintenance and anticipated renewal needs as system facilities age. In these same years, the system has received on average \$41.9 million in HEAPR funding, or approximately 38% of the requested amount.

TABLE 2: HEAPR Requested and Received

Year	HEAPR Requested	HEAPR Received	% Received
2006	\$110.0	\$40.0	36%
2007	\$30.0	\$0.0	0%
2008	\$110.0	\$55.0	50%
2009	\$50.0	\$40.0	80%
2010	\$110.0	\$52.0	47%
2011	\$58.0	\$30.0	52%
2012	\$110.0	\$20.0	18%
2013	\$90.0	\$0.0	0%
2014	\$110.0	\$42.5	39%
2015	\$72.5	TBD	TBD
2016	\$110.0		

Funding for individual capital projects have fared better than asset preservation over time. On average, the board has approved \$208.5 million total for capital projects in traditional even numbered capital bonding years. In those same years, the system has received on average \$124.1 million, or 60% of the amount requested for projects.

TABLE 3: Capital Projects Requested and Funded

Year	Project Requested	Project Received	% Received
2006	\$170.4	\$151.4	89%
2007	\$.8	\$0.0	0%
2008	\$240.2	\$185.7	77%
2009	\$67.1	\$0.0	0%
2010	\$286.8	\$54.2	19%
2011	\$221.8	\$101.6	46%
2012	\$168.7	\$112.1	66%
2013	\$61.4	\$0.0	0%
2014	\$176.5	\$117.3	66%
2015	\$125.5	TBD	TBD
2016	\$176.8		

NEXT STEPS

All capital bonding requests are to be submitted to Minnesota Management and Budget (MMB) via the state’s electronic capital budget system no later than June 30, 2015, and preparations commence for a bonding book outlining the various capital projects. The legislature will use the state information and bonding book in preparation for site visits around the state this summer and fall to become familiar with proposed capital requests from all state entities.

Given the volatility in the construction market, specific project cost estimates on **Attachment A** may change over the coming months as some design work is completed on previously funded projects and MMB publishes additional guidance on project inflation rates. Final adjustments to the requested projects must occur no later than October, 2015 for preparation of the Governor’s capital budget recommendation for the 2016 legislative session.

CONSTRUCTION BUDGET ANALYSIS

During the May Finance Committee discussion of this request, the Committee asked for details on cost growth of prior year construction programs. In a review of both the major capital and revenue fund financed construction projects since 2010, only 6 of 75 projects in programs totaling \$555.4 million required additional funding. Four projects required funding to fully execute the original project scope and intent and two projects required additional funding to meet institutional project scope changes.

TABLE 4: Major Project Funding and Program Changes

Funding Year	Program	Original Funding/Projects	Program Funding Changes	Notes
2010	Capital	\$54.2M/9	(\$1.95M)	7 of 9 projects provided funds for conversion to HEAPR for campus use
2011	Capital	\$101.6M/7	(\$296K)	1 project provided funds for conversion to HEAPR
2011	Revenue Fund	\$104.0M/9	\$0	
2012	Capital	\$112.1M/17	(\$1.17M)	4 of 17 projects provided funds for conversion to HEAPR for campus use
2013	Revenue Fund	\$66.2M/7	\$7.4M	2 of 7 projects required additional funding (NOTE 1)
2014	Capital	\$117.3/26	\$637K	4 of 26 projects required additional funding through HEAPR and/or campus general funds (NOTE 2)
TOTAL		\$555.5/75	\$4.62M	

NOTE 1: Construction of two projects at Metropolitan State University (Parking Ramp and Student Union) encountered unforeseen contaminated soil requiring mitigation, costing a total of \$7.4M beyond the original project budget. This figure does not reflect modifications to Maria Avenue to meet City of St Paul traffic flow needs totaling \$1.9M

NOTE 2: Two projects required \$213K in HEAPR funding to address asbestos abatement and ADA restroom compliance requirements identified after original funding. Two projects required \$424K in additional funding to meet institutional scope changed after original project funding.

The system's construction programs are managed to be fully executed within the appropriated amounts. System office program managers and college and university leadership and project managers work diligently to bring projects in on budget. In the years 2010-2012, programs were somewhat favored by the soft construction market and actually returned project savings back to campuses for asset preservation. That trend appears to have disappeared and the state's construction market had heated up. The system has solved any cost increases internally and has never sought additional appropriations.

RECOMMENDED COMMITTEE ACTION:

The Finance and Facilities Committee recommends that the Board of Trustees adopt the following motion:

The Board of Trustees approves the 2016 capital bonding request as presented in **Attachment A**, specifically the projects and priorities for 2016. The Chancellor is authorized to make cost and related adjustments to the request as required, and to forward the request through Minnesota Management and Budget to the Governor for consideration in the state's 2016 capital budget. The Chancellor is authorized to make adjustments to **Attachment A** if

warranted as a result of a 2015 special session of the Legislature after consultation with the Chair of the Board and the Chair of the Finance committee. The Chancellor shall advise the Board of any subsequent changes in the capital bonding request prior to the 2016 legislative session. In addition, as funding is authorized and appropriated by the legislature and approved by the Governor, the Chancellor or his designee are authorized to execute those contracting actions necessary to deliver on the project scope and intent.

RECOMMENDED BOARD OF TRUSTEES ACTION:

The Board of Trustees approves the 2016 capital bonding request as presented in **Attachment A**, specifically the projects and priorities for 2016. The Chancellor is authorized to make cost and related adjustments to the request as required, and to forward the request through Minnesota Management and Budget to the Governor for consideration in the state's 2016 capital budget. The Chancellor is authorized to make adjustments to **Attachment A** if warranted as a result of a 2015 special session of the Legislature after consultation with the Chair of the Board and the Chair of the Finance committee. The Chancellor shall advise the Board of any subsequent changes in the capital bonding request prior to the 2016 legislative session. In addition, as funding is authorized and appropriated by the legislature and approved by the Governor, the Chancellor or his designee are authorized to execute those contracting actions necessary to deliver on the project scope and intent.

Date Presented to the Board: June 17, 2015

ATTACHMENT A

Draft 2016 Capital Bonding Recommendation – Proposed Priority List

	Institution	Project	Requested	Recommended
1	Systemwide	HEAPR – Asset preservation	\$125,000,000	\$110,000,000
2	Minnesota West Community and Technical College	Powerline technology training facility - Jackson	\$2,410,000	\$2,410,000
3	Minnesota West Community and Technical College	Geothermal HVAC system-Englund Hall - Canby	\$857,000	\$857,000
4	Dakota County Technical College	Transportation and emerging technologies renovation phase II	\$7,733,000	\$7,733,000
5	Saint Paul College	Health, Science Alliance Center addition	\$18,829,000	\$18,829,000
6	South Central College	STEM and Healthcare - North Mankato	\$8,600,000	\$8,600,000
7	Minnesota State Community and Technical College	Center for Student and Workforce Success	\$1,635,000	\$1,635,000
8	Minnesota State Community and Technical College	Library and Student Development Renovation - Wadena	\$738,000	\$738,000
9	Northland Community and Technical College	Laboratory Renovations	\$826,000	\$826,000
10	Bemidji State University	Academic learning center and campus renovation (Hagg-Sauer)	\$18,097,000	\$18,097,000
11	Rochester Community and Technical College	Memorial and Plaza Halls Demolition Design and Renovation	\$20,385,500	\$20,385,500
12	Hibbing Community College	Campus Rightsizing	\$9,958,000	\$9,958,000
13	Winona State University	Education Village Phase II Renovation	\$22,630,000	\$22,630,000
14	St. Cloud State University	Student Health & Academic renovation	\$18,572,000	\$18,572,000
15	MSU, Mankato	Clinical Sciences Phase 2	\$6,525,000	\$6,525,000
16	Anoka Ramsey Community College	Nursing & Active Learning Center Design and Humanities Renovation - Coon Rapids	\$4,965,000	\$4,965,000
17	Century College	Applied Technology Center	\$5,500,000	\$5,500,000
18	Hennepin Technical College	Advanced Manufacturing Integration and Revitalization, Ph 1, Brooklyn Park	\$8,231,000	\$8,231,000
19	Normandale Community College	Classroom and student services renovation	\$13,215,000	\$1,100,000
20	MSU Moorhead	Weld Hall renovation (Design)	\$775,000	\$775,000
21	Inver Hills Community College	Technology and Business Center	\$12,662,000	\$1,000,000
22	Riverland Community College	Transportation, Trade and Industrial Education Center	\$7,427,000	\$7,427,000
23	Twin Cities Metro Region	Twin Cities baccalaureate solution	\$10,000,000	\$10,000,000
PROGRAM TOTAL:			\$325,570,500	\$286,793,500

Board Approved 2014/2015
Projects

DEBT CAPACITY ANALYSIS

In modeling debt capacity, the system established an annual debt service target of no more than 3% of annual operating revenues. For analysis purposes, the base year operating revenue is derived from FY14 financial statements and represents unrestricted funding sources that may be eligible to pay debt service. Operating revenues for that purpose include tuition and fees, appropriations, and scholarship and grant revenues. The amount excludes restricted revenues, such as fees from the operations of revenue fund facilities.

One-Third Rule

Upon passage of a bonding bill, the state of Minnesota issues debt in the form of general obligation bonds for capital projects. Since the early 1990s, both public higher education systems in Minnesota have been obligated to pay the debt service on one-third (1/3) of the principal amount of general obligation bonds sold to finance capital projects authorized by a bonding bill. As of the 2014 financial statements, the current outstanding principal associated with system capital bonding projects is \$232 million and the total debt service payable in 2015 was \$31.7 million. Half of the debt would be passed on to the individual institutions receiving the project with the remaining half paid for by the system. HEAPR projects are not subject to the one-third debt service rule.

Student Cost

By itself, the student cost of capital bonding debt is very low, and softened by two factors: 1) that the state does not charge the system debt service for HEAPR, and 2) only one-third (1/3) of the debt service for capital projects is paid by the system, while the remaining two-thirds (2/3) is paid by the state.

The impact of capital bonding debt is further lessened by how the system allocates debt responsibility between the individual campus benefiting from the project and the system as a whole. In an analysis completed for the legislature in 2012 and updated for 2014 numbers, the system reported that institutional debt service averaged about \$3.34 per credit for FY14, and historically has ranged between \$1.50 and \$3.34 per credit. Notably, enrollment volatility has a major impact on the cost estimates per credit.

This calculation assumes that all debt service was being paid out of tuition. In reality, colleges and universities use a combination of tuition, state appropriation and other revenues to pay operating expenses, including debt service.

Forecasting Need

The system used the 2014 Capital Budget of \$176 million per biennium as a guide for future capital request modeling. The amount includes capital projects only and does not include HEAPR appropriations, where debt is not charged to the system. Three questions were analyzed:

1. What is the impact on the system with a consistent, \$176 million capital project request every biennium?
2. How much more debt service could the system handle?
3. How much could revenue decline before reaching the 3% debt threshold?

Analysis

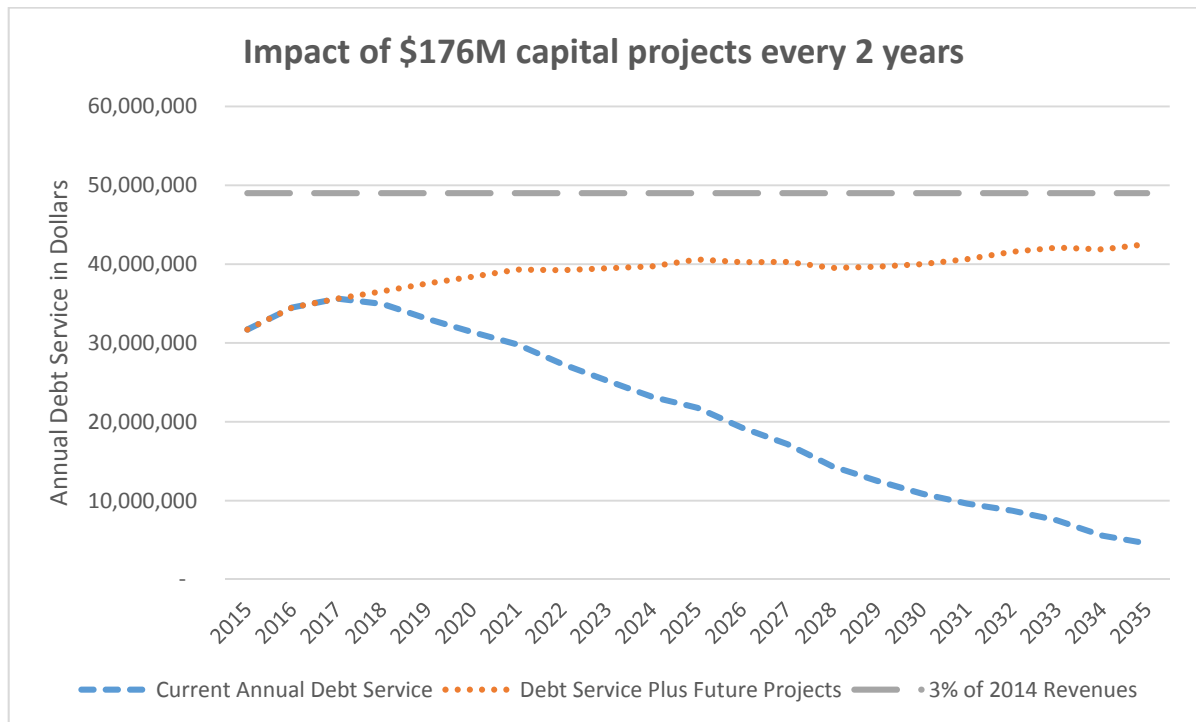
1. What is the impact on the system with a consistent, \$176 million capital project request every biennium?

The assumptions under this first scenario include:

- Current debt service
- Flat revenues into the future
- New debt service on \$176 million of new capital projects each biennium
- Excludes HEAPR
- Bond interest = 4% true interest cost

Result: Under the above assumptions, the system would be able to add \$176 million per biennium and comfortably remain under the 3% threshold for the next 20 years and likely longer. This scenario is graphically represented by the following chart:

Chart 1: 20 Year Debt Service Trend at \$176M of Capital Project Requests Each Biennium



2. How much debt service could the system handle?

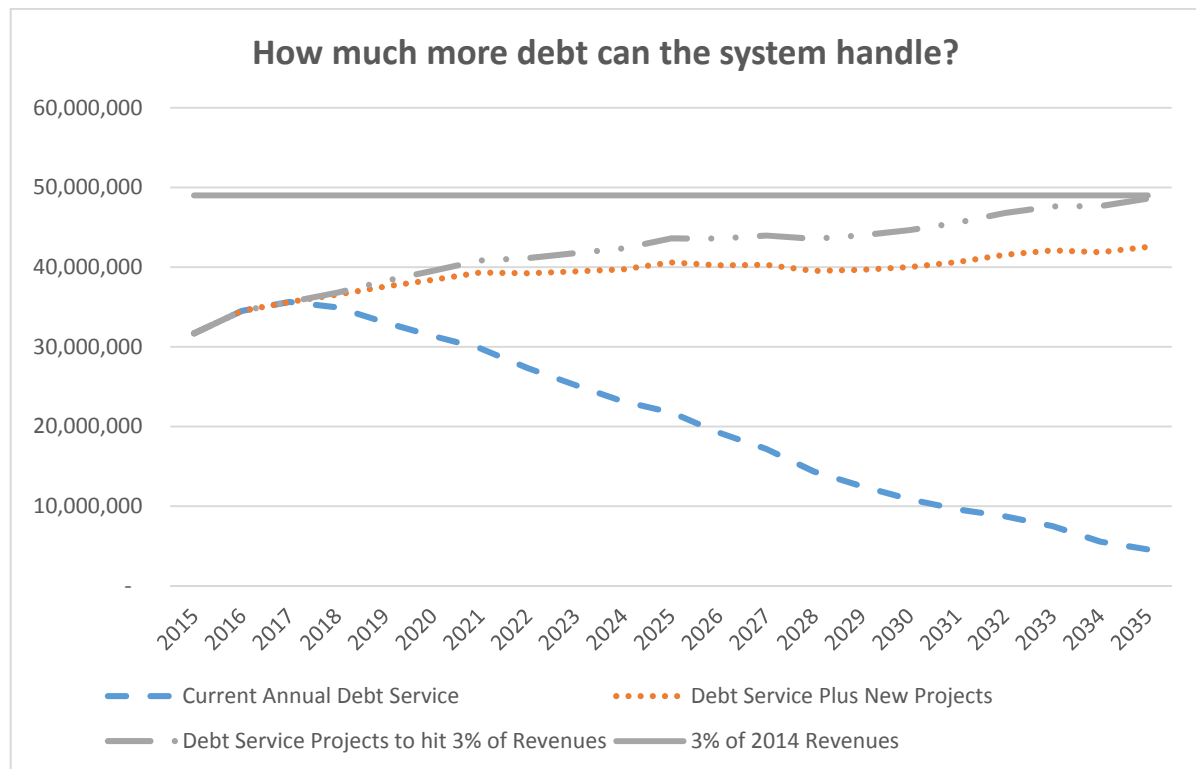
This scenario assumed the following factors:

- Current debt service
- Flat revenues into the future
- Excludes HEAPR
- Bond interest = 4% true interest cost

The approach to this question controls for interest rate shifts and holds revenue flat, and looks at what sort of additional capacity the system would have to pursue more capital projects above \$176 million per biennium.

The chart below includes the current debt service, projected flat revenues, the annual projected debt service based on capital projects of \$176 million per biennium and the projected debt service based on capital projects of \$205 million per biennium, which is down somewhat from projections of \$232 million for 2014.

Chart 2: 20 Year Debt Service Trend at \$176M and \$205M of Capital Project Requests Each Biennium



Based on the above, the system would generate at its peak approximately \$48-49 million worth of projected annual debt service that the system could support. This translates into an average

capital project request of approximately \$205 million per biennium for the next 20 years before reaching the 3% revenue threshold around 2035.

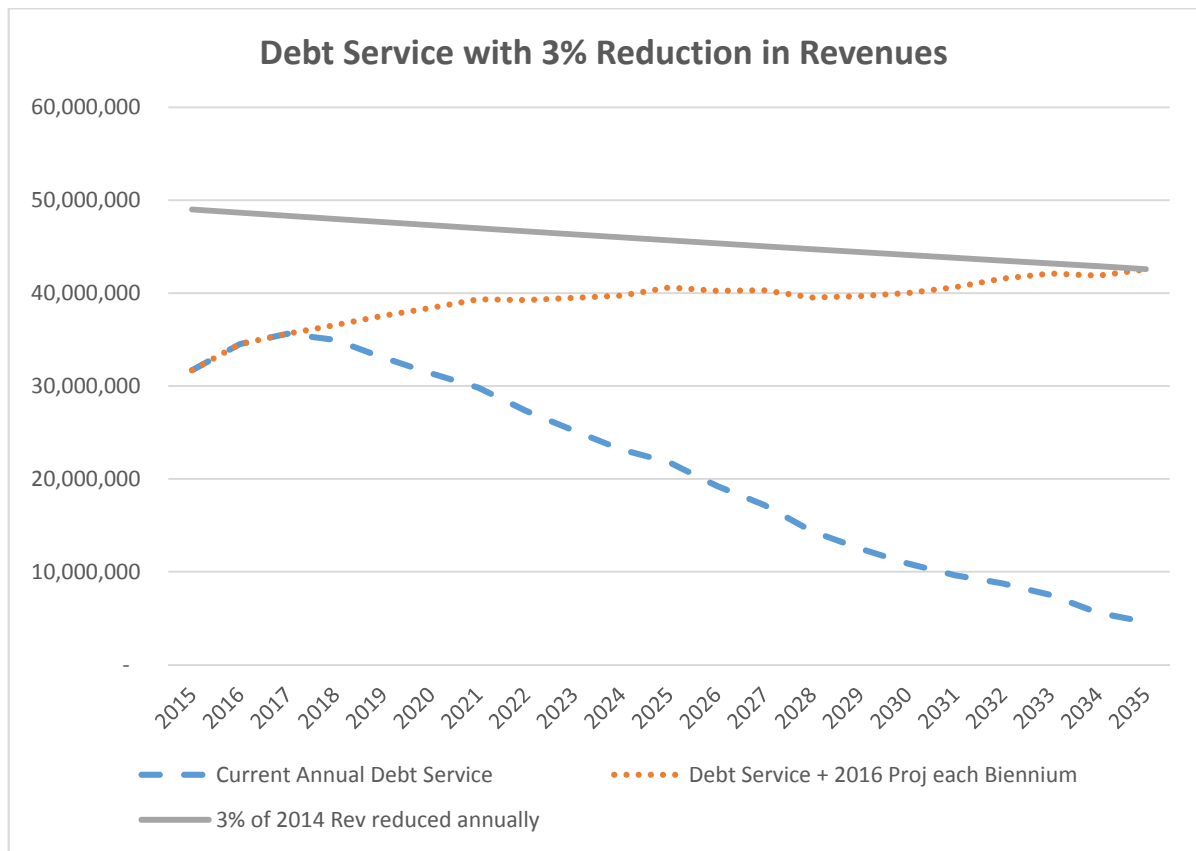
3. How much could revenue decline before reaching the debt threshold?

This scenario assumes:

- Current debt service
- Adding \$176 million per biennium
- Decreasing revenues
- Excludes HEAPR
- Bond interest = 4% true interest cost

The last scenario evaluates how much revenues would have to decline before reaching the 3% revenue threshold, assuming continued requests of \$176 million in capital projects per biennium. The chart below shows that revenues would have to decline an average of 3% annually before the threshold would be reached around 2035.

Chart 3: 20 Year Debt Service Trend at \$176M of Capital Project Requests Each Biennium and Declining Revenues



Summary

At present rates, the student burden attributable to capital project debt service is about \$3.46 per credit assuming all debt service is paid by tuition. At current revenue rates and modest increase in bond interest rates, the system can still regularly afford \$176 million worth of capital projects in biennial bonding bills without dramatically increasing that cost to students. However, enrollment declines make that proportion susceptible to variability. The system could afford as much as \$205 million worth of capital projects per biennium at present projections and remain under the 3% threshold until about 2035. By contrast, revenues could decline by an average of 3% annually for the next 20 years before the debt service would hit the 3% revenue threshold.