AGENDA

JOINT MEETING OF THE COMMITTEE ON FINANCE AND THE COMMITTEE ON CAMPUS PLANNING, BUILDINGS AND GROUNDS

Meeting: **2:30 p.m., Tuesday, March 25, 2014**
Glenn S. Dumke Auditorium

Committee on Finance
Roberta Achtenberg, Chair
Rebecca D. Eisen
Douglas Faigin
Margaret Fortune
Steven M. Glazer
Lou Monville

Committee on Capital Planning Buildings and Grounds
Rebecca D. Eisen, Chair
J. Lawrence Norton, Vice Chair
Douglas Faigin
Margaret Fortune
Lou Monville
Cipriano Vargas

Discussion

1. Capital Financing and the 2014-2015 Governor's Budget Proposal, *Information*

JOINT MEETING

COMMITTEE ON FINANCE
COMMITTEE ON CAMPUS PLANNING, BUILDINGS AND GROUNDS

Capital Financing and the 2014-2015 Governor’s Budget Proposal

Presentation By

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Capital Planning, Design and Construction

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Budget

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Acting Deputy Assistant Vice Chancellor
Financing Treasury and Risk Management

Summary

This item provides information on the Governor’s Budget proposal to increase the California State University support budget to fund previously approved capital outlay projects and to provide the CSU greater authority to finance capital projects to support the academic program. This item also provides information on capital outlay for the board’s consideration of the governor’s proposal.

Background

The use of general funds and student tuition fees for capital outlay is limited. The Budget Act limits operating fund expenditures to $100,000 per improvement project. For proposed expenditures greater than this amount, Department of Finance (DOF) approval is required and the project must not exceed $634,000. There is no limit on the use of operating funds for special repairs or maintenance of existing building or infrastructure systems. There is also no limit on the use of interest earnings on student tuition fees for capital purposes. Operating funds may also be used for leases, including use for equipment lease financing. Use of equipment lease financing can be used to fund certain high dollar value infrastructure repair/replacement projects. This information is provided to specify the few management tools available to CSU to manage facility deficiencies using the operating budget.

Governor's Budget Proposal

This is the third year the governor has proposed a significant change in the budgeting and funding of CSU capital improvements. This proposal aims to require the CSU to factor capital costs into the university's overall fiscal outlook and decision-making process. The following provisions are part of the 2014-2015 proposal:

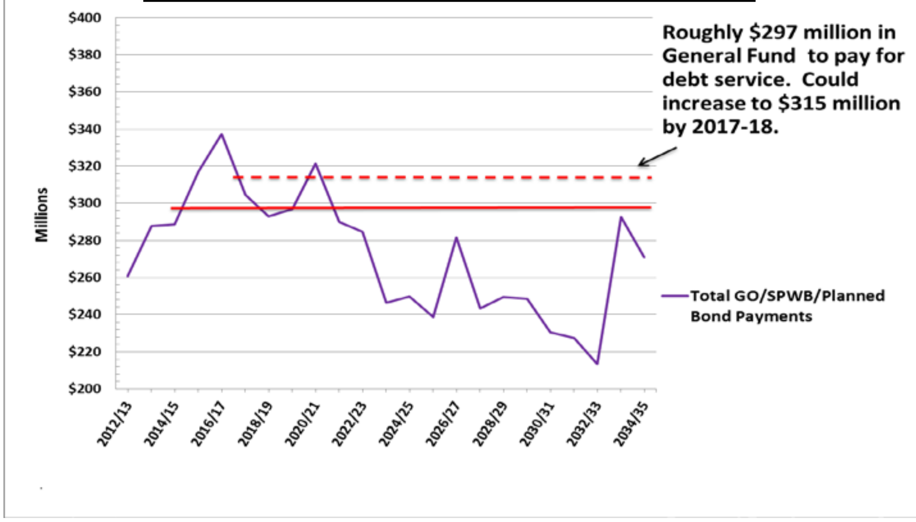
- Shift the budget for debt service on General Obligation (GO) bonds and State Public Works Board (SPWB) bonds that have been issued on behalf of the CSU from the state to the CSU on a permanent basis. Key components of this shift include:
    - Permanently increase the CSU general fund base budget by approximately $297 million to accommodate the debt service shift ($198 million for GO bond debt service and $99 million for SPWB bond debt service).
        - Adjustments to the CSU general fund base budget are expected to be made in the future to accommodate changes in the SPWB debt service per commitments made by DOF. This would result in the annual SPWB debt service amount increasing from $99 million in 2014-2015 to about $117 million by 2017-2018 (an $18 million increase).
        - This would increase the total debt service from $297 million to $315 million by 2017-2018. However, this potential increase would not be codified in legislation and would be subject to approval in future budget cycles.
    - Authorize the CSU to use up to 12 percent of its annual general fund support appropriation to secure CSU debt issued pursuant to the State University Revenue Bond Act of 1947[1] ('47 Bond Act), provided that the obligations are used to:
        - Refund, restructure, or retire SPWB bond debt;
        - Fund academic buildings and infrastructure projects.
    - Fund projects on a pay-as-you-go basis within the same 12 percent annual general fund support appropriation limit.
    - Streamline the project submittal process to the DOF and the legislature.
- Authorize the pledge of all revenues to secure CSU debt or fund pay-as-you-go projects. The revenues would not be subject to the 12 percent limit placed upon the annual general fund support appropriation.
- Add flexibility to allow the CSU to utilize the new authorities under the '47 Bond Act, to expand the existing Systemwide Revenue Bond (SRB) program.

[1] The State University Bond Act of 1947 is the authority under which the CSU's Systemwide Revenue Bond program was created.

Key Implications of the Governor's Budget Proposal for the CSU

Figure 1 shows the total GO and SPWB annual debt payment amounts and the proposed support budget increase of $297 million and the expected increase to $315 million.

Figure 1- Total Annual Debt Payments

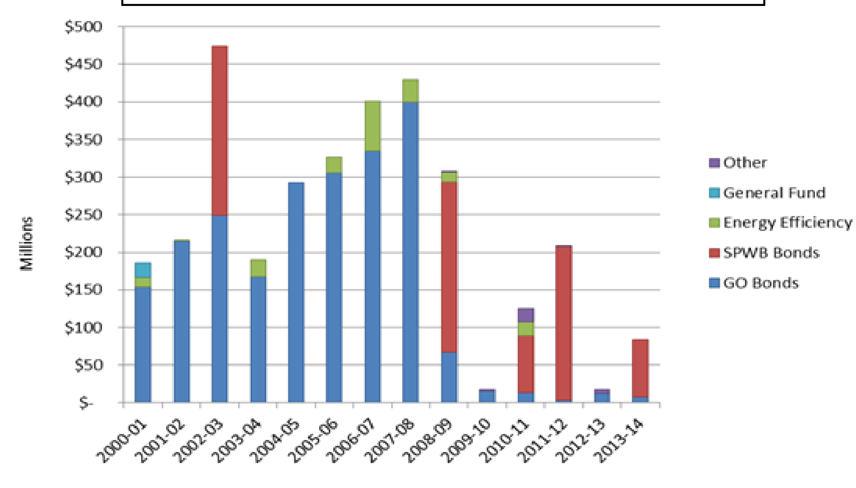


- Due to changes in the annual total bond payment schedule:
  - $297 million will not be sufficient to cover the debt service in five of the seven years through 2020-2021, with the highest shortfall $40 million (2016-2017). In such cases, the governor expects the CSU would make use of its own resources.
  - Presuming DOF honors its commitment, the expected debt service increase to $315 million would reduce the highest shortfall from $40 million to $22 million.
  - Over time, the annual debt payments decline, thereby freeing up cash flow for new capital purposes, including debt issuance, or other purposes.
- The proposal will provide the CSU with the ability to refund or restructure the SPWB debt and lower the debt service, thereby freeing up cash flow.
- The proposal enables the CSU to finance academic buildings and infrastructure by expanding the Systemwide Revenue Bond program, or create a new debt program.
- The proposal supports the CSU Board of Trustees budget request to use operating funds of $15 million per year for three years (or $45 million) to secure financing proceeds of roughly $400 to $700 million to address critical infrastructure needs. The range in the dollar amount reflects the potential change in the interest rate on the bonds (higher interests rates will reduce the amount of proceeds) and Board of Trustees policy decisions on the structure of the expanded debt program (e.g., should a reserve amount be budgeted from the $15 million).

Determining the Appropriate Capital Outlay Funding Level

Currently, the highest priority driver in the capital outlay program is the need to address our aging buildings and utility distribution systems. Figure 2, shows that our capital bond funding had increased to about $400 million in 2007-2008. This amount was supported by the administration and legislature to correct deficiencies in existing facilities and to support enrollment growth. The last kindergarten-higher education GO bond was approved in 2006; Figure 2 shows the decline in state GO bonds and resulting reliance on SPWB bonds.

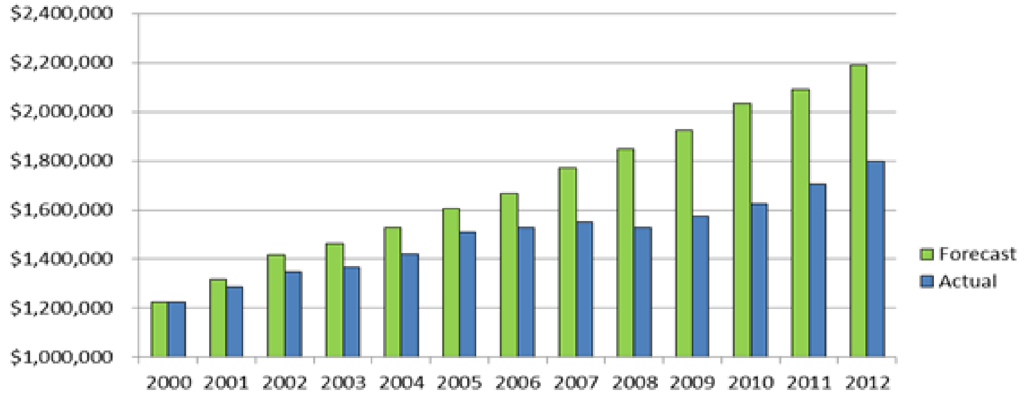
Figure 2 – State Capital Outlay Funding



However, the SPWB bonds cannot be used for partial building renovations including seismic upgrades or infrastructure improvements. The lack of GO bond funds limited the CSU's ability to reinvest in existing buildings and caused the capital renewal backlog to begin to increase again in 2009, after successfully slowing the rate of increase in 2006 (Figure 3)[2]. The figure shows that the backlog of renewal needs would have approached $2.2 billion if the CSU had not used GO bonds to invest in renewal of existing buildings.

[2] Capital Renewal projects typically involve the replacement of building systems like electrical, heating ventilating and air conditioning, plumbing, exterior skin, etc. that have exceeded their useful life.

Figure 3 – Forecast of Capital Renewal



As a result of these investments, the current estimated renewal backlog of systems that have passed their useful life is $1.8 billion. The average annual amount needed to replace systems and make progress on the backlog is over $242 million per year.

Next Steps

The Governor's Budget Proposal and changes proposed by the CSU are still subject to final approval by the legislature. If the governor's proposal is adopted, it will be necessary to:

- Determine the structure of a revised CSU capital financing program.
- Develop policy recommendations, such as:
  - Financing Policy Revisions
  - Pledge of Revenues
  - Allocation Methodology for the Revenues and Capital Funding Resources
- Identify implementation timelines—running the capital financing program through an expanded SRB program can be implemented faster than developing a new, separate debt program.
- Develop refinancing strategies for the SPWB Debt—the timing and structure of any refinancing of existing SPWB debt will be determined by Board policy and appetite for different financial instruments, CSU needs, and market conditions.