Report of the Joint Capital Bond Study Committee

Submitted to the Members of the Joint Bond Review Committee

Pursuant to Proviso 117.133 of the FY2015-16 Appropriation Act

December 31, 2015

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Overview

The Joint "Capital Bond Study Committee" ("the Committee") was created pursuant to Proviso 117.133 of the FY2015-16 Appropriation Act for the primary (but not exclusive) purpose of studying the "…capital needs of the state's higher education institutions, including the technical college system."

Specifically, Proviso 117.133 directed that the Committee's study "…shall include, but is not limited to: (1) capital improvement plans of higher education institutions; (2) long term capital bond needs; (3) bond capacity and debt service; (4) other related subjects that may serve to inform the General Assembly and the Governor as determined by the committee; and (5) the merits, necessity and projected costs of each of the capital improvement plans and projects it studies and prepare recommendations addressing the priority of the projects for future funding."

To assist in accomplishing this charge, and in accordance with subsection (C) of Proviso 117.133 which states that "The committee may solicit information from any person or entity it deems relevant to its study", the Committee met three (3) separate times and, in addition to considering information provided by staff, heard expert testimony from: 1) a former Deputy State Treasurer of South Carolina and current Director of Capital Planning for the South Carolina Department of Administration; the State Treasurer of South Carolina and staff of the Office of State Treasurer; the Director of the South Carolina Revenue and Fiscal Affairs Office and Chief Economist of the South Carolina Board of Economic Advisors; the Interim Director of the South Carolina Commission on Higher Education; and the Director of the Executive Budget Office of the South Carolina Department of Administration.

Note that while the Committee did not ultimately consider its purpose to recommend or reject passage of a capital improvement (CIB) "bond bill", or to recommend a prioritized list of capital projects which should receive allocations under such legislation, the Committee nevertheless believes its series of findings, observations, items of information, and/or recommendations contained in this report will be of value to policymakers and to the public if such legislation is ever considered. Specifically, the high-level but in-depth findings and information submitted herein by the Committee should serve as an important reference and resource for all policymakers, including those who may not have been in their current capacities when the last CIB "bond bill" was passed by the General Assembly in 2001.

Note: "Video transcripts" (including copies of meeting materials provided to Committee members) of each of the Committee's 3 meetings may be viewed by visiting the following internet link (See also Appendix A of this report):

http://www.scstatehouse.gov/CommitteeInfo/JointCapitalBondStudyCommittee/JointCapitalBondStudyCommittee.php

Committee Membership:

Appointment:	Appointed By:
Senator Harvey Peeler, Chairman	Senate Majority Leader
Senator Thomas Alexander	Senate Finance Committee Chairman
Senator Vincent Sheheen	Senate Minority Leader
Representative James Merrill	House Ways and Means Chairman
Representative J. Todd Rutherford	House Minority Leader
Representative Gary Clary	Speaker of the House of Representatives
Mr. Chad Waldorf	Governor
Mr. David Ellison	Governor
Dr. Russ Sobel	Governor

Committee Staff:

Mr. Craig Parks, Sr. Research and Budget Analyst, Senate Finance Committee
Ms. Kara Brurok, Budget Analyst, House Ways and Means Committee

Study Committee Meetings*

*As previously noted, "Video transcripts" (including copies of meeting materials provided to Committee members) of each of the Committee's 3 meetings may be viewed by visiting the following internet link (See also Appendix A of this report):

http://www.scstatehouse.gov/CommitteeInfo/JointCapitalBondStudyCommittee/JointCapitalBondStudyCommittee.php

Meeting 1

Date: November 9, 2015
Time: 1:00 PM
Location: 105 Gressette Building

Members & Staff Present:
Senator Harvey Peeler
Senator Thomas Alexander
Representative James Merrill
Representative Todd Rutherford
Representative Gary Clary
Mr. David Ellison
Mr. Craig Parks, Senate Staff
Ms. Kara Brurok, House Staff

Meeting Overview:
Mr. Rick Harmon, Director of Capital Planning, with the SC Department of Administration presented to the Committee. Mr. Harmon addressed the state's legal authority to incur indebtedness; types of general obligation debt authorized by the constitution; a summary of past bond bills and the areas of state government that benefitted from them; a general overview of debt capacity; and a historic perspective of the rating services' views of the state, their expectations about the planning process, and other rating considerations. Mr. Harmon also addressed questions of the Committee.

Meeting 2

Date: November 30, 2015
Time: 1:00 PM
Location: 105 Gressette Building

Members & Staff Present:
Senator Harvey Peeler
Senator Thomas Alexander
Representative James Merrill

Representative Gary Clary
Mr. David Ellison
Mr. Chad Waldorf
Dr. Russ Sobel
Mr. Craig Parks, Senate Staff
Ms. Kara Brurok, House Staff

Meeting Overview:
The Honorable Curtis Loftis, State Treasurer, provided the Committee with a detailed overview of the mission of the State Treasurer's Office (STO) and its role in state debt administration; STO's interaction with the 3 major credit rating agencies (Fitch Ratings, Moody's Investors Service, Inc., & Standard & Poor's Credit Market Services); the State's current credit ratings and trends to include an overview of the state's credit strengths and/or challenges considered by each; debt authorization for the State to include legal capacity calculations and limits; and an estimate of the State's current general obligation debt service analysis through FY18-19. Mr. Frank Rainwater, Executive Director of the SC Revenue & Fiscal Affairs Office, provided the committee an overview of historic trends in "construction cost" metrics and measures related to the overall construction and borrowing environment including inflationary and interest rate trends in the U.S. historically. Finally, Mr. Gary Glenn, Interim Executive Director of the SC Commission on Higher Education, addressed the Comprehensive Permanent Improvement Plan (CPIP) process as it pertains to higher education, provided information regarding issues and concerns about repair and maintenance needs on public college campuses and offered a series of capital process improvements as well as suggestions regarding funding of repair and maintenance needs on public college campuses. Each presenter also addressed questions of the Committee.

Meeting 3
December 8, 2015
1:00 PM - 308 Gressette Building

Members & Staff Present:
Senator Harvey Peeler
Senator Thomas Alexander
Senator Vincent Sheheen
Representative Gary Clary
Mr. David Ellison
Mr. Chad Waldorf
Mr. Craig Parks, Senate Staff
Ms. Kara Brurok, House Staff

Meeting Overview:

Ms. Brenda Hart, Director of the Executive Budget Office (EBO), with the SC Department of Administration, provided the Committee an overview of the state's "Comprehensive Permanent Improvement Plan" (CPIP) process as it pertains to all state agencies, including the state's public colleges and universities, and EBO's overall role in the process. Specifically, Ms. Hart offered a brief history of CPIP along with an explanation of each of the 5-years of CPIP related to information state agencies are expected to provide to include, but not necessarily limited to, conditions of existing facilities and demands on those facilities to include maintenance, facility replacement needs, information regarding maintenance plans and maintenance fund balances, financial summaries of proposed agency projects and priority status of those projects and additional detail for Years 2-5 of an agency's CPIP. Ms. Hart also addressed questions of the Committee.

Findings, Observations and Items of Information

Debt Overview, Generally
The South Carolina General Assembly has the legal authority (within certain limits described below) to issue debt ("bonds") under the state's Constitution.

According to the Office of State Treasurer (STO), "The need for borrowed funds is initiated by the General Assembly and the State's agencies and the Office of State Treasurer assists them with forming a plan to receive the borrowed funds and to repay them in a timely manner." (See Appendix B, page 4). Note: For information regarding STO's legal authority and role regarding state debt, see Appendix B, pages 4-6.

According to STO, "Not since 1879 has there been any default, actual or technical, on any bonded debt of the State." STO also notes that "Not since 1932 has there been any incurrence of debt from external sources to fund operating deficits of the State." (See Appendix C, page 13).

Debt Overview, Types
The state Constitution limits debt the state and its agencies can issue to two (2) types: 1) "General Obligation" (G.O.) and 2) "Revenue. G.O. debt is "backed" (paid for) by the state's "general" revenue stream which is comprised primarily of general tax revenue (most notably individual income and sales tax). The technical nomenclature for G.O. debt paid for by general tax revenue is that such debt is backed by "the full faith and credit of the state".

In contrast to G.O. debt, revenue debt is not backed by the full faith and credit of the state, but is supported from either a revenue stream derived from the project the debt is funding (such as parking fees for a parking garage) or from a special (non-tax) source. While G.O. debt is limited to a maximum "debt service" and/or "fixed dollar" cap (as discussed in greater detail below), revenue debt is usually not subject to such limits (with the exception of athletic revenue debt of public colleges and universities). Instead, according to STO, "…rating agency and market/investor expectations dictate marketability, generally quantified by the ratio of the pledged revenue stream to debt service." (See Appendix C, page 11).

Note: While the primary focus of the Committee was G.O. debt backed by the full faith and credit of the state, information regarding "revenue" bonds was received by the Committee, particularly with regards to revenue related bonds of the state's public colleges and universities. Specifically, Proviso 11.30 of the FY2015-16 Appropriation Act required public colleges and universities to provide the General Assembly a detailed report regarding each institution's "outstanding institutional debt". (See Appendix D for a copy of each public college's and/or university's institutional debt report pursuant to Proviso 11.30).

G.O. Debt, Generally
Regarding G.O. debt, the state is limited to three (3) specific types of G.O. bonds that can be issued: 1) highway bonds, 2) state institution bonds and 3) G.O. bonds for "any public purpose". It is this third category of G.O. debt that the Committee primarily reviewed. For a description of highway bonds and/or state institution bonds, see Appendix C, pages 16-17. Note: While highway and state institution bonds are technically backed by the full faith and credit of the state,

these bonds are in practice primarily backed by a specific revenue source (i.e., "tuition" in the case of state institution bonds) and debt limit constraints are therefore tied to a specific revenue source, rather than the state's overall debt limits.

G.O. Debt, Limits
Regarding this 3rd category of G.O. debt (debt for "any public purpose"), policymakers are constrained by law as to how much debt they can issue. Specifically, policymakers are limited so that no more than 5% of the state's general fund revenue can be spent on "debt service". Debt service is the amount of money necessary to make principal and interest payments on outstanding debt. Note: The Constitution provides that the General Assembly may exceed the 5% limit upon a two-thirds (2/3) vote provided that: 1) the debt is limited pursuant to the specifications of the authorization and 2) the debt matures within 30 years. (See Appendix C, page 7).

The state Constitution also provides that the General Assembly (upon a two-thirds vote) can adjust this limit down to 4% or up to no more than 7%. The current debt service limit is 6%, with the General Assembly having increased the 5% limit to include 2 separate one-half of one-percent (½%) debt categories (with limits); the first being for economic development bonds and the second being for research university infrastructure bonds. (See Appendix C, pages 3-6 for a more complete description of economic development bonds and/or research university infrastructure bonds).

Bond authorizations by policymakers in recent years have notably focused on economic development related projects, with an example being Boeing (with up to $410 Million in bonds "authorized" since 2009). Most recently, the Joint Bond Review Committee (JBRC) and the State Fiscal Affairs Authority (SFAA) authorized up to $123 Million in bonds for Volvo should bond funding (not to exceed this amount) be necessary to assist with this specific economic development project. Note: An "Authorization" does not necessarily mean bonds have (or will) actually be "issued". (See Appendix K for a copy of the JBRC agenda item whereby bond authorization related to Volvo was granted).

As noted above, an additional limit regarding the 5% G.O. debt category is that amortization of the debt (the period of time the debt "matures") must be no more than 30 years, effectively providing further constraint to the state's 5% debt service limit. Note: While the state's Constitution limits amortization to 30 years, the General Assembly, with longstanding advice from STO, has, in most cases, "self-limited" amortization to 15 years.

It is also noted that the Constitution specifically requires the General Assembly to "…allocate on an annual basis sufficient tax revenues to provide for the punctual payment of the principal of and interest on such general obligation debt." The practical effect of this Constitutional requirement is that policymakers treat debt service payments as "open ended" obligations of the state budget. This means that in times of economic downturn, when state agency budgets are being reduced to maintain a balanced state budget, debt service payments are exempt from such reductions to ensure that creditors are paid on time, and in full.

The Committee also notes that South Carolina conforms to the definition of "good practice" regarding capital financing and debt management by the National Association of State Budget Officers (NASBO) which encourages states to "Develop clear debt policies that limit debt burdens to a percentage of revenue collections on the taxable base." Specifically, NASBO considers it "good practice" to set policies regarding total outstanding debt and debt service (to) ensure that prior spending commitments do not crowd out current and future operating budgets." (See Appendix E, page 5).

G.O. Debt, "Capital Improvement Bonds"
A more familiar type of debt in the 5% G.O. debt category (G.O. debt for "any public purpose") is known as "capital improvement" debt, or more commonly, "capital improvement bonds" (CIBs). CIBs are issued by the General Assembly through the normal legislative process by passage of a "CIB bond bill" ("bond bill"). According to STO, bond bills are legally limited debt issuances in support of "…capital projects generally, and specifically for capital projects for various institutions and state agencies." (See Appendix C, pages 1-2).

The General Assembly passed the first bond bill in 1968 and passed its most recent bond bill in 2001. Prior to 2001, the General Assembly regularly approved bond bills in support of capital needs of state-owned facilities, equipment and/or infrastructure. Specifically, between 1968 and 2001, the General Assembly adopted bond bills in 26 out of 33 years. During this period, bond bills ranged in size from $187,000 in 1976 to $299 million in 1999. The most recent bond bill (2001) totaled approximately $137 million. In total, the General Assembly has issued $2.6 billion in CIB bonds since 1968 across all functional areas of state government. Note: This figure excludes the special $750 million bond appropriation in 1999 for K-12 school facilities "…for the purpose of assisting school districts to provide adequate educational facilities". (See Appendix F for a summary of CIB bond bills since 1968 and Appendix C, page 1-2 for explanation of the special K-12 bond in 1999).

According to Mr. Rick Harmon (former Deputy State Treasurer and current Director of Capital Planning for the South Carolina Department of Administration), between 1986 and 2001, public colleges and universities were the largest recipient of bond bill authorizations, having received 45% ($745 million) of allocations, followed by state correctional agencies at 22% ($375 million), K-12 at 12% (excluding the special bond in 1999), and the remainder of state agencies receiving 10% or less of bond allocations during that period. (See Appendix G, page 3).

As information, according to a recent Southern Regional Education Board (SREB) survey of "Capital Funding of Public Higher Education", of the 14 states that responded to the survey (there are 16 SREB states in total), 10 have issued G.O. bonds for public colleges and universities since 2001, with 7 having issued G.O. bonds for public colleges and universities since 2014. (See Appendix H for a summary of survey results as well as detailed survey responses for each state, including South Carolina).

G.O. Debt, Debt (and Debt Service) History
Since 2001, South Carolina has reduced its total G.O. debt (5% limit category) from $1.75 Billion in 2001 to $428.7 Million in 2015. During this period, associated debt service appropriations have ranged from $168.6 million (or 3.2% of recurring general fund

appropriations) to a high of $228.3 million (or 4.4% of recurring general fund appropriations) in 2004, to $191.6 million (or 2.5% of recurring general fund appropriations) today (FY2015-16). Note: This figure ($191.6 million) does not include $17.2 million of available debt service "carried forward" into the current fiscal year, but not otherwise utilized. (See Appendix I for 5% debt and debt service history).

According to STO, the state's current debt service appropriation (FY2015-16) for total G.O. debt outstanding is approximately $209 million allocated as follows: $122 million for the 5% debt class; $44 million in economic development related debt; $24 million for research university infrastructure bonds; approximately $600,000 for miscellaneous G.O. debt; and $17 million carried forward but not otherwise allocated. (See Appendix J).

G.O. Debt (and Debt Service), Future Capacity
Mr. Harmon noted that the state's legal capacity to issue additional G.O. debt via a bond bill is expected to be "…significant…over the next few years from the retirement and refinancing of capital improvement and school facilities bonds issued in the early 2000's." (See Appendix G, page 3).

Related, Mr. Harmon also noted that "…the state's current debt service requirement (is) well situated within Constitutional constraint…" and that "…Moody's latest publication of state debt medians made in May, 2015 indicates that South Carolina is positioned favorably among other states within Moody's measures of debt affordability." (See Appendix G, page 5).

As a matter of technical advice, Mr. Harmon recommended that the Committee "…may wish to consider these comparative statistics and indicators of debt affordability in conjunction with the state's constitutional debt capacity to confirm the reasonableness of any potential bond authorization. Note: This technical advice is not to be construed as an endorsement by Mr. Harmon (or the Committee) of a bond bill. (See Appendix G, page 5 for a summary of South Carolina's ranking on each of Moody's four (4) separate measures of debt affordability).

Estimates provided by STO indicate that the state's debt service required to pay for outstanding G.O. debt (including the 5% and additional categories over and above the 5% category previously noted) will reduce from $209 million in the current budget year (FY2015-16), to $133 million in FY2016-17, $109 million in FY2017-18, and $92 million by FY2018-19; a total reduction of approximately $107 million over the next 3 fiscal years. Note: By FY2018-19, required debt service appropriations for economic development related bonds will comprise the largest share of total required appropriations ($37 million, followed by $32 million for the 5% category and $20 million for research university bonds). (See Appendix J).

Regarding the legal debt service capacity for the 5% debt limit category available to the state in the upcoming fiscal year (FY2016-17), STO estimates that there is an additional $204 million of legal "capacity" over and above the current $122 million of debt service currently appropriated. Note: While not required by statute, STO recommends that policymakers "set aside" 20% of otherwise legal capacity to accommodate for future general fund "volatility". Adjusting for this volatility factor, STO estimates that capacity is $163 million more than what is currently appropriated for the 5% debt limit category. (See Appendix B, page 21).

As a matter of information, STO provided the Committee with an estimated size of a CIB bond bill that could technically be considered by policymakers during the upcoming legislative session, assuming a debt service appropriation not to exceed $200 million and other factors. Specifically, according to STO, assuming: 1) a total G.O. debt service appropriation of $200 million, 2) adopting STOs recommended 20% volatility factor, 3) amortizing the bonds over 15 years rather than 30 years, and 4) assuming an interest rate of 5%, policymakers could technically consider a $1 billion CIB bond bill. According to STO's estimate, due in part to the continued amortization of existing debt, required debt service payments under the above scenario will reduce from $209 million today, to $174 million by FY2018-19. Note: This technical information provided by STO is not to be construed as an endorsement of a bond bill by STO (or the Committee). (See Appendix B, page 19).

G.O. Debt, Credit Rating Agency Reviews

According to STO, South Carolina is one of eleven (11) "highly rated states". Specifically, 2 of the country's 3 major credit rating agencies (Fitch and Moody's) rate the state's G.O. debt as "Triple A" (AAA/AAa). The third firm, Standard and Poor's (S&P), affords the state its next highest rating of AA+. These ratings mean that the state is viewed as either a "minimal" or "very low" credit risk, providing the state lower interest rates compared to states with higher ratings. (See Appendix B, page 8).

Note: See Appendix B, pages 9-11, for STO's summary of the 3 rating agencies overview and outlook of the state's credit worthiness. Specifically, as noted by STO, each firm considers the state's current outlook "stable" and each also generally gives credit to the state for its "strong financial management", "fiscal controls", "budget practices that include healthy reserve balances" and/or its "demonstrated willingness" to "align" expenditures with revenues during economic downturns.

The Committee notes as information that the State Treasurer's formal presentation highlighted a quote from S&P related to South Carolina's public pension and retiree benefit liabilities. Specifically, according to S&P, "South Carolina's high pension liability and deteriorating pension funded ratio limits the likelihood of a higher rating in the next two years. Although not expected in the near term, should recurring state revenue become significantly misaligned with recurring expenditures, pressuring budgets and reserve balances, we could lower the rating." (See Appendix B, page 9).

For comparative reference, the Committee also notes that while pension funding ratios are also an expressed concern for the other 2 rating firms, Fitch and Moody's do not include the same statement (as S&P) regarding a possible rating downgrade relative to the state's pension and OPEB liabilities. Note: According to STO, rating agency reports are "proprietary" and "confidential" (See Appendix B, pages 9-11). However, an internet search of the public domain yields a copy of Fitch's May 2015 rating report of South Carolina's G.O. debt in which it, while expressing caution regarding the state's pension funding ratios, ultimately concludes that, "On a combined basis, the burden of the state's net tax-supported debt and adjusted unfunded pension obligations equals a manageable 5.5% of 2014 personal income, below Fitch's calculations of state medians." Related, Fitch similarly states that "On a combined basis, debt and unfunded pension liabilities are a manageable and below-average burden on state resources." (See Appendix L for a copy of Fitch's May 2015 rating of the state's G.O. debt, to include its commentary on the state's credit strengths and challenges, including pension liabilities).

As information, according to data provided by the state's Public Employee Benefit Authority (PEBA), the combined unfunded liability of the state's five (5) separate public pension programs increased from approximately $17.36 billion in 2013 to $17.97 billion in 2014 (with the actuarial liquidation period of the state's largest pension program, SCRS, equaling 30 years), while post-employment retiree benefits (OPEB) decreased from $9.40 billion in 2013 to $9.34 Billion in 2014. (See Appendix M for a copy of PEBA's actuarial valuations, assumptions and explanations regarding the state's current and historic pension and OPEB liabilities).

In 2012, the state enacted pension reform legislation (Act 278) which, among other measures, capped future cost-of-living adjustments for retirees, increased new employees' service and age requirements, raised contribution requirements for employers and employees, and created PEBA to oversee both the state's employee insurance program and retirement plans. Note: Evaluation of these pension reforms is outside of the scope of the Committee's study.

Construction and Borrowing Costs, Generally
The Committee received information from Mr. Frank Rainwater (Executive Director of the South Carolina Revenue and Fiscal Affairs Office and the state's Chief Economist) regarding historic trends in "construction cost" metrics and measures related to the overall construction and borrowing environment (both past and present). Note: Mr. Rainwater's observations regarding construction costs and the overall current borrowing environment do not represent his prediction of future trends, nor do they represent a recommendation by Mr. Rainwater (or the Committee) regarding the timing of a potential bond bill, if any, by policymakers.

A summary of highlights from Mr. Rainwater's presentation to the Committee is as follows:
-General Inflation. Inflation, as measured by the "Consumer Price Index" (CPI-U) is currently below its mean rate of growth over the last 16 years, and is lower than the CPI-U in 2001.
-Construction Inflation. As measured by the "construction cost index", construction inflation is currently below its mean rate of growth over the last 16 years, and is lower than the construction cost index in 2001. Note: Construction inflation has risen at a faster pace than general inflation over the past three (3) years.
-Construction Employment. Total construction employment has grown each of the last three (3) years (2011-2014), but is below both the level of employment in 2001 and peak sector employment in 2007 (125,000 total construction employment in 2007 vs. approximately 83,000 in 2014).
-Interest rates - Federal Funds Rate. The federal funds rate is below its mean rate over the last 16 years and is below the federal funds rate of 2001 (approximately 4% in 2001 vs. approximately 0% today).
-Interest rates - AAA Municipal Bond Rate. The average interest rate on AAA municipal bonds is below the average interest rate over the last 16 years and is below the average interest rate in 2001 (approximately 4.8% in 2001 vs. approximately 2.6% today).
(For a copy of Mr. Rainwater's full presentation to the Committee see Appendix N).

Higher Education Capital Funding, Generally
According to Mr. Harmon, "Bond raters and their assessment criteria are sensitive to growing but unaddressed capital needs (of states) because they represent future liabilities that potentially affect the rated entities' financial flexibility." (See Appendix G, page 4).

The Committee notes that while the state's overall bond ratings are "high" and the state's outlook is "stable", the outlook of public colleges and universities is somewhat less favorable due (at least part) to external factors outside of institutional control. Specifically, according to Mr. Harmon, in 2013, Moody's revised the higher education sector's national outlook to "negative", citing "…strained non-tuition revenue sources as operating revenues from state appropriations continue(s) to stagnate or decline, and research funding, already flat (as) being vulnerable to federal budget cuts." Mr. Harmon also highlighted Moody's 6 South Carolina specific higher education related ratings determinations between December 2010 and May 2013 in which each cited "…reduced, declining, significant, or dramatic cuts in state appropriations, and a high dependence or increased reliance on student charges as rating challenges, while generally crediting institutions with successfully managing declining appropriations over successive fiscal years." (See Appendix G, page 4).

Note: See Appendix O for data regarding historic trends in state appropriated funding to public colleges and universities (both in terms of actual recurring operating funding from the state as well as how the share of that funding has changed over time relative to the state budget as a whole) including information regarding capital funding from the state to public colleges and universities from the state's primary "capital fund" (known as the "Capital Reserve Fund"). (See Appendix H for a summary of recent capital funding provided to public colleges and universities among 14 of the 16 SREB states, including South Carolina).

Higher Education Funding, Facility Repair and Maintenance, Specifically
The Committee received information regarding funding requirements of public colleges and universities related to maintenance and repair of facilities and capital equipment. As Mr. Harmon noted (about capital funding in general), "Some needs that might otherwise have been funded through enactment of a bond bill have been addressed in other ways, like fee increases and other revenue enhancements; increase in borrowing at the institutional level; supplemental, capital reserve or other on-time appropriations; and deferrals in capital improvements that might otherwise have been undertaken. The latter is potentially problematic because as deferral continues over time, costs grow as a result of inflation and exacerbation of underlying defects and deterioration." (See Appendix G, page 4).

According to information from the South Carolina Commission on Higher Education (CHE), the state's public colleges and universities academic related facilities are aging, with almost 70% at least 25 years old or older, and more than one-third (34%) described by CHE as "really old" (at least 50 years old older). (See Appendix P, page 5).

CHE indicates that of the state's 813 public college and university academic related facilities, less than 25% have a building condition rating of "90-100", which is defined by the Association of Physical Plant Administrators (APPA) as the "acceptable standard". (See Appendix P, page 2).

According to a CHE "maintenance need" survey last updated in 2012, the estimated amount needed to maintain and/or renew academic building space and systems so that they reach their full expected lives is approximately $1.2 billion over 20 years, or an estimated $64 million per year (See Appendix P, pages 1-3).

As information, for the current year (FY2015-16), the General Assembly appropriated approximately $4.8 million for general repair, maintenance, renewal and/or capital equipment needs to be shared across each of the state's 33 public colleges and universities and an additional $23.3 million targeted to specific colleges for specific repair and maintenance projects. Note: See the "Recommendations" section of this report for a recommendation by the Interim Executive Director of CHE regarding a proposal for statewide funding for repair and maintenance needs across the state's public colleges and universities.

For information regarding actual expenditures for repair and maintenance by public colleges and universities, see Appendix P, pages 11-13.

Capital Approval Process, Generally

The Committee reviewed the state's statutory capital approval process (also referred to as the "permanent improvement process"). The permanent improvement process is multi-layered, and depending on a capital project's estimated cost or other factors, the process typically requires a series of review(s) by state entities, authorities and/or committees to include: the state agency or institution proposing a capital project (including a state agency's board or commission as applicable); CHE and/or the State Board for Technical and Comprehensive Education if the agency is a state public college or university, as applicable; JBRC and the State Fiscal Accountability Authority (SFAA).

The Committee notes that, as stated in Section 2-47-10 of the South Carolina Code of Laws, "…a need exists for careful planning of permanent improvements and of the utilization of state general obligation and institutional bond authority in order to ensure the continued favorable bond credit rating our State has historically enjoyed. It (the General Assembly) further finds that the responsibility for management of these matters is properly placed upon the legislative and executive branches of government."

To assist with this management, there exists within the South Carolina Department of Administration's Executive Budget Office (EBO) a "Capital Budgeting Unit" (CBU) which works collaboratively with JBRC and SFAA to help guide project requests through the capital approval process. Additionally, CBU tracks project budgets and expenditures, assists agencies in gaining approvals for land acquisitions, donations, and/or exchanges, and works with state agencies and STO to develop semi-annual bond draw schedules to govern the release of capital improvement bond funds for authorized projects.

Note: The Executive Director of the South Carolina Department of Administration recently formed a "Capital Planning" office within the Department to which, as previously noted, she named Mr. Rick Harmon, Director. According to Mr. Harmon, his role is to "…evaluate the state's major assets, determine their expected useful lives and where we are within the asset life cycle, and develop an orderly plan that will lead to an informed implementation of matching available resources against liabilities attached to the acquisition, maintenance, replacement, and in some cases, disposal of those assets over time. (See Appendix G, page 1).

A primary role of CBU is to facilitate the planning process for state agencies' capital improvements programs through what is known as the "Comprehensive Permanent Improvement Plan" (CPIP).

CPIP exists pursuant to statute and, among other things, requires that "All state agencies responsible for providing and maintaining physical facilities are required to submit a Comprehensive Permanent Improvement Plan (CPIP) to the Joint Bond Review Committee and the authority (SFAA)." (See Appendix R for a copy of Section 2-47-55 of the South Carolina Code of Laws pertaining to CPIP).

According to information provided by Ms. Brenda Hart, Director of EBO, CPIP was established in 2002 but was temporarily suspended by the General Assembly during the Great Recession (FY2008-09 - FY2012-13). Note: During the suspension period, public colleges and universities were still required to submit "Year 1" plans electronically. CPIP was reinstated by the General Assembly in FY2014-15 and state agencies are currently working with CBU to finalize their CPIP submissions for the FY2016-17 fiscal year. For a copy of state agencies current CPIP plans (FY2015-16), see the following internet link: http://www.admin.sc.gov/budget/capital-budgeting-unit/CPIP.

Specifically, CPIP is a 5-year plan which provides state policymakers a comprehensive (and longer-term view) of state agencies anticipated capital needs over a 5-year period. According to Ms. Hart, CPIP serves three (3) primary purposes: 1) as a planning tool for state agencies (including public colleges and universities) to review their facility needs over the next 5-years; 2) as a mechanism for making agencies' permanent funding needs known to policymakers; and 3) for public colleges and universities, CPIP offers a mechanism by which a group of projects can receive approval from CHE at the beginning of a fiscal year without having to bring each project separately to the Commission throughout the year. (See Appendix S, page 1).

The Committee notes that CBU, in its written instructions to state agencies regarding CPIP preparation and submittal, expects agencies to "be reasonable in your proposed projects, especially with projects for which state appropriated funds are expected to be requested. This plan should not be a wish list of projects (for which) you would like funding…but a realistic plan (instead)…" (See Appendix T, page 6).

Regarding funding of CPIP projects, Ms. Hart noted that the CPIP process places its greatest emphasis on Years 1 and 2, and that Year 1 CPIP projects should: 1) be able to be initiated by the agency within the year (Year 1) and 2) project funding should already be available (or be reasonably expected to be available). According to Ms. Hart, "These (Year 1) projects should not be dependent upon receiving a state appropriation or capital improvement bonds." (See Appendix S, page 1).

In contrast to Year 1, Ms. Hart noted that, "For Years 2 through 5", agencies may or may not have a source of funding identified." Rather, as Ms. Hart stated, "It is anticipated that requests for appropriations will be included in the agency's annual budget request. Projects to be initiated in Year 2 that will require State Appropriations or Capital Improvement Bonds should clearly show this. For Years 3 through 5, projects are listed with an estimate of their cost and an indication of the anticipated source funds." (See Appendix S, pages 1-2).

Note: See Attachment U for a copy of "Form C". Form C is EBO's budget template completed by state agencies to indicate (and provide justification for) their capital and/or other non-recurring budget requests for the upcoming fiscal year. "Form C" is utilized by both the Governor and the General Assembly as an evaluative tool in helping to determine capital funding for state agencies. To review state agency "Form C" capital requests for the upcoming fiscal year (FY2016-17), see the following internet link:
http://www.admin.sc.gov/budget/agency-budget-plans/current-budget-plans.

The Committee notes Ms. Hart's testimony whereby she indicated that since "restructuring" (i.e, creation of the South Carolina Department of Administration), EBO's role in the CPIP process has become increasingly "analytical" which she notes as a positive development, and she further notes that while her office does not currently have any suggested improvements to CPIP or the permanent improvement process, she does envision offering recommendations possibly within a year, which she indicated could eventually lead to draft CPIP regulations that could be considered by the General Assembly within the next several years.

Capital Approval Process, Higher Education Specifically
The Committee also received detailed information from Mr. Gary Glenn, the Interim Executive Director of CHE, regarding the capital approval process related to the state's public colleges and universities, specifically related to CHE's role and responsibilities in that process.

See Attachment V, page 1, for a copy of Mr. Glenn's "flow-chart" which details the various steps that public colleges and universities must take before a capital project can be approved. Detail includes requisite steps (from "need recognition" to project "closeout") beginning at the institutional level, CHE level, as well as the JBRC and SFAA steps of the process.

Regarding CPIP specifically, Mr. Glenn noted that "The purpose of Year One of the CPIP is to approve at one time each institution's permanent improvement plans for the coming year, except for emergencies and other unanticipated needs. "Year 2 includes, but is not limited to, requests for capital improvement bonds." "Years 3-5 represent the institutions' long-term plans and are presented as information only." (See Attachment V, page 2).

The Committee also notes that Mr. Glenn made a series of recommendations regarding possible improvements to the permanent improvement process. Note: While the Committee has taken no formal action regarding Mr. Glenn's recommendations, it nevertheless advances them for consideration in the Recommendations section of this report. (See Recommendations section).

Recommendations

As noted at the outset of this report, the Committee did not consider its purpose to recommend or reject passage of a capital improvement (CIB) “bond bill”, or to recommend a prioritized list of capital projects which should receive allocations in any such bill. Instead, as demonstrated in the preceding sections of this report, the Committee is primarily advancing a series of high-level but detailed items of information and observations that it believes will provide useful reference to both policymakers and the public if and when such legislation is ever proposed and/or advanced for debate. However, while the Committee is not advancing its own specific recommendations, it is submitting as information for consideration (without formal action by the Committee), a series of recommendations made to the Committee by the Interim Director of the South Carolina Commission on Higher Education, which are as follows:

-Consider increasing the PIP threshold for new construction projects to reduce delays in processing. Current threshold is $500,000.

-Consider increasing the PIP threshold for maintenance, renewal and refurbishment projects to reduce delays in processing. Current threshold is $1,000,000.

-Consider using CPIP Year 1 to approve the entire project budget. Consider raising the 1 1/2 % cap on A&E (Phase 1) and allow staff to process the construction phase (Phase 2) if certain parameters are met.

-Consider approving the entire project budget for interim capital projects reserving the approval criteria used for CPIP approved projects.

-Consider basing funding priorities on CPIP Year 2 scoring for projects requesting support through the Capital Improvement Bond Bill (CIB) to inform legislators of state rather than institutional priorities.

-Consider funding maintenance needs based on life-cycle analysis and the amount needed to support in-state students. Note: See Appendix Q for CHE’s recommended funding formula associated with this recommendation).

-Consider establishing a policy requiring institutions to have a maintenance reserve account and allow annual state contributions for support of maintenance needs to be deposited into the reserve account and to carryover to accommodate larger maintenance project costs.

Appendices

See separate attachment.