

**RECOMMENDATION TO THE LEGISLATIVE
FINANCE COMMITTEE
FROM
THE SUBCOMMITTEE ON
LRBP CASH PROGRAM FUNDING**

A Report Prepared for the
Legislative Finance Committee

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LONG-RANGE BUILDING CASH PROGRAM FUNDING SUBCOMMITTEE RECOMMENDATIONS

INTRODUCTION

At the request of the Legislative Finance Committee, the Long-Range Building Cash Program Funding subcommittee analyzed options for the future funding of the Long-Range Building Program (LRBP). The subcommittee was charged with developing recommendations on two issues, the inadequate funding level of the LRBP and how to reduce the deferred maintenance backlog. Both situations exist because most of the major maintenance (and deferred maintenance) project funding comes from cigarette tax revenues. As the program revenues have decreased, many major maintenance projects have been postponed, causing the deferred maintenance backlog to grow. After hearing staff recommendations of different methodologies to address these issues, the subcommittee focused their efforts on two proposals: 1) a rental surcharge assessed by agency based on number of square feet occupied and a renewal rate, developed for each building type and 2) a future maintenance funding endowment trust based on an existing statute, Title 17, Chapter 7, part 206, MCA. Both proposals were analyzed for potential costs issues and the outcome if implemented.

PROPOSALS

The subcommittee determined that the LRBP cash program had two funding issues to be considered. The first issue was declining funding for the ongoing costs of the LRBP cash maintenance program. The second issue was the deferred maintenance backlog, which is conservatively estimated at \$240 million. The subcommittee determined that it would be beneficial to address the two funding issues differently. The two funding recommendations that address the funding issues are described below.

Rental Surcharge

The first funding idea analyzed by the subcommittee, a rental surcharge, would address ongoing program/major maintenance costs. A rental surcharge ties the cost of major maintenance to buildings. In the first step of designing a rental surcharge methodology, staff of Architecture and Engineering (A&E) created a building classification system of 12 types of buildings that are included in the LRBP eligible state building inventory. After classifying the state buildings, A&E staff computed “renewal” rates for each of the building types. The rates were initially developed as total maintenance rates and were based on industry recommendations and historical expenditures. The rates were then reduced by the amount of funding that is already provided for normal maintenance. Next, the rates were transformed into an average per square foot cost. Finally, agency allocations were determined based on the product of the renewal rates and the square feet of occupancy.

The rental surcharges have been developed (renewal rate times square feet by building classification) as biennial allocations, and could be appropriated to either agencies or to the LRBP. The allocation rates would need to be increased biennially for the effects of inflation. Additionally, each interim the state building inventory would have to be updated. Figure 1 in the appendix shows the building classifications and the current square feet of occupancy by agency by building type. As seen in this figure, there are currently 9.9 million square feet of building space eligible for a rental surcharge. The tables in Figure 2 of the appendix show the major maintenance allocation rates by agency and per classification, both annually and biennially for the next five biennia. The calculations of the estimated cost are increased biennially by an annual non-residential construction rate of 3.9 percent. For these estimates, no consideration was given to growth in the actual building inventory. For the 2009 biennium, the cost of this plan would be \$34.3 million.

Future Maintenance Endowment Trust

The second funding concept that the subcommittee analyzed was a future maintenance endowment trust, which could provide funding to slowly reduce the backlog of deferred maintenance. This proposal would utilize existing statute, 17-7-206, MCA. Statute currently states that for buildings recommended for construction, the

legislature may allocate an amount not to exceed two percent of the appropriated cost for maintenance. To make this statute functional, a number of statutory additions and changes would be required. The subcommittee recommends amending the statute to make the necessary changes and change the appropriation reference to say, “at least one percent shall be appropriated” rather than “up to two percent may be appropriated”. The future maintenance appropriation would exempt projects funded with bond proceeds, to avoid the potential for arbitrage (earning a return on bonded debt) on the tax-exempt bonds.

LRBP representatives from the Governor’s Office of Budget and Program Planning (OBPP) have stated their intent to provide a one-time distribution of \$30 million to the LRBP next biennium. The subcommittee recommends using the one-time distribution to initiate a LRBP endowment trust. Further, if the two proposals are accepted, appropriations of one percent of the cost of all major maintenance/capital projects would create deposits of nearly \$300,000 in the 2009 biennium, growing to near \$500,000 over the next four biennia. Figure 3 in the appendix shows interest income that would become available for backlogged deferred maintenance projects. The analysis assumes an interest rate of 6.12 percent (the average rate of bond earnings).

OUTCOMES

Together, the two proposals, the rental surcharge and LRBP endowment trust, would provide sufficient funding for the ongoing major maintenance of state-owned buildings and provide funds to reduce the current deferred maintenance backlog. With full funding of the ongoing major maintenance, the backlog of deferred maintenance projects will stop growing. The funding provided through the LRBP endowment trust, together with the current funding stream, would be used to reduce the deferred maintenance backlog. However, the two proposals come at a significant cost to the general fund, about \$64 million.

Figure 4 in the appendix shows total funding of the LRBP generated with these two proposals.¹ The cost of the rental surcharge would be appropriated from the general fund in HB 2, and would cost \$34 million in the first biennium. The future maintenance endowment trust would have a one-time cost to the general fund of \$30 million. Again, the proposal would make use of one-time only funds that OBPP has indicated might be transferred to the LRBP in the 2009 biennium. The two recommendations of the subcommittee will have an initial cost \$64 million above current funding in the first biennium. The rental surcharge option will have an ongoing cost to the general fund of \$34 million plus inflation.

The subcommittee recognized that any proposal to increase funding to the LRBP would create a new cost to the general fund. While the subcommittee discussed using other types of taxes to fund the LRBP, any “new funding source” would have to come from a new tax. Members of the subcommittee were adverse to the idea of a new tax. Consequently, increased program funding, regardless of how it gets into the program, would be a cost to the general fund.

RECOMMENDATIONS

The LRBP Cash Program Funding Subcommittee recommends that the Legislative Finance Committee (LFC) approve the funding proposals, the rental surcharge and the LRBP endowment trust, described above. If adopted, the subcommittee will request bill drafts for presentation at the October meeting of the LFC.

ACTION OPTIONS

The LFC could:

- Approve both of the subcommittee recommendations
- Approve either the rental surcharge or the LRBP endowment trust
- Disapprove either or both of the subcommittees recommendations
- Take no action

¹ Figure 4 assumes that the agency maintenance surcharge would flow into the LRBP project account and is shown as revenues to the LRBP and project expenditures from the account.

APPENDIX

Figure 1

Building Classifications and Square Feet of Building Occupation by Agency and Building Type

Montana State Building Classifications		
Building Classification	Code	Renewal Rate
Athletic Facilities	AF	2.08%
Student Unions/Dining Halls	D	2.30%
Medical Facilities	HN	2.59%
Correctional Facilities	J	3.47%
Basic Lab/Vacational Shop	LA-B	2.90%
Hi-Tech Laboratories	LA-H	3.76%
Monumental/Museum	MU	2.91%
Classroom/Office Buildings	O	2.16%
Parking Facilities	PKG	1.71%
Central Plants/Tunnels	PL	2.14%
Dormitory/Housing Units	R	2.21%
Warehouse/Storage Facilities	ST	2.73%

Current Square Feet of Occupancy by Agency (building values greater than \$100,000)												
Agency	Classification Codes											
	Square Feet of Occupation (LRBP Eligible Buildings) by Building Type and Agency											
	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total
Board of Education	50,874	5,603			9,072			53,458	3,000	41,398		163,405
Administration						106,346	314,406	853,752	7,100	11,955	45,850	1,339,409
Agriculture					7,888							7,888
Corrections		21,481	14,341	675,988				76,145	14,524	5,803	77,340	885,622
Military Affairs								418,031			91,207	509,238
Natural Resources and Conservation								75,451			28,128	103,579
Public Health and Human Services	25,962	29,038	300,334	15,328				101,863	16,626	141,967	221,680	852,798
Revenue											91,781	91,781
Justice	8,764	14,000	2,016					18,340		45,723		88,843
Montana State University	115,872				1,105,725	271,218	95,463	1,365,424	34,324	33,627	109,108	3,130,761
University of Montana	<u>43,085</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>879,447</u>	<u>0</u>	<u>36,394</u>	<u>1,557,456</u>	<u>86,553</u>	<u>21,034</u>	<u>62,963</u>	<u>2,686,932</u>
Total Square Feet	<u>244,557</u>	<u>70,122</u>	<u>316,691</u>	<u>691,316</u>	<u>2,002,132</u>	<u>377,564</u>	<u>446,263</u>	<u>4,519,920</u>	<u>162,127</u>	<u>301,507</u>	<u>728,057</u>	<u>9,860,256</u>

Figure 2

Five Biennia Rental Surcharge Cost Per Agency by Square Feet Occupancy of Building Type (LRBP Eligible Buildings)

2009 Biennium													
Agency	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total	Biennial Cost
Annual Allocation Rate (Cost / SF)	\$0.79	\$1.31	\$1.89	\$3.18	\$1.92	\$3.68	\$5.45	\$1.22	\$0.78	\$0.72	\$0.77	\$1.74	\$3.48
Board of Education	40,082	7,363	0	0	17,415	0	0	64,959	2,350	29,781	0	284,013	\$568,027
Administration	0	0	0	0	0	390,898	1,712,845	1,037,428	5,562	8,600	35,189	2,328,021	4,656,041
Agriculture	0	0	0	0	15,142	0	0	0	0	0	0	13,710	27,420
Corrections	0	28,230	27,121	2,148,152	0	0	0	92,527	11,378	4,175	59,356	1,539,296	3,078,591
Military Affairs	0	0	0	0	0	0	0	507,966	0	0	69,999	885,104	1,770,208
Natural Resources and Conservation	0	0	0	0	0	0	0	91,684	0	0	21,587	180,030	360,060
Public Health and Human Services	20,455	38,162	567,987	48,709	0	0	0	123,778	13,024	102,130	170,133	1,482,244	2,964,489
Revenue	0	0	0	0	0	0	0	0	0	0	70,439	159,524	319,048
Justice	6,905	18,399	3,813	0	0	0	0	22,286	0	32,893	0	154,418	308,835
Montana State University	91,293	0	0	0	2,122,629	996,922	520,071	1,659,182	26,889	24,191	83,737	5,441,561	10,883,123
University of Montana	33,946	0	0	0	1,688,249	0	198,270	1,892,527	67,803	15,132	48,322	4,670,144	9,340,288
Total	<u>\$192,681</u>	<u>\$92,155</u>	<u>\$598,921</u>	<u>\$2,196,861</u>	<u>\$3,843,435</u>	<u>\$1,387,820</u>	<u>\$2,431,186</u>	<u>\$5,492,337</u>	<u>\$127,006</u>	<u>\$216,902</u>	<u>\$558,763</u>	<u>\$17,138,066</u>	<u>\$34,276,132</u>

2011 Biennium													
Agency	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total	Biennial Cost
Annual Allocation Rate (Cost / SF)	\$0.85	\$1.42	\$2.04	\$3.43	\$2.07	\$3.97	\$5.88	\$1.31	\$0.85	\$0.78	\$0.83	\$1.88	\$3.75
Board of Education	43,278	7,951	0	0	18,804	0	0	70,138	2,537	32,156	0	306,658	\$613,315
Administration	0	0	0	0	0	422,064	1,849,408	1,120,141	6,005	9,286	37,994	2,513,631	5,027,262
Agriculture	0	0	0	0	16,350	0	0	0	0	0	0	14,803	29,606
Corrections	0	30,481	29,284	2,319,421	0	0	0	99,904	12,285	4,507	64,089	1,662,022	3,324,043
Military Affairs	0	0	0	0	0	0	0	548,466	0	0	75,580	955,673	1,911,345
Natural Resources and Conservation	0	0	0	0	0	0	0	98,993	0	0	23,309	194,384	388,768
Public Health and Human Services	22,086	41,204	613,272	52,593	0	0	0	133,646	14,063	110,273	183,698	1,600,422	3,200,844
Revenue	0	0	0	0	0	0	0	0	0	0	76,055	172,243	344,486
Justice	7,455	19,866	4,117	0	0	0	0	24,062	0	35,515	0	166,729	333,458
Montana State University	98,572	0	0	0	2,291,863	1,076,405	561,535	1,791,466	29,032	26,120	90,414	5,875,411	11,750,821
University of Montana	<u>36,652</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,822,851</u>	<u>0</u>	<u>214,078</u>	<u>2,043,416</u>	<u>73,209</u>	<u>16,338</u>	<u>52,175</u>	<u>5,042,489</u>	<u>10,084,979</u>
Total	<u>\$208,043</u>	<u>\$99,502</u>	<u>\$646,672</u>	<u>\$2,372,014</u>	<u>\$4,149,868</u>	<u>\$1,498,469</u>	<u>\$2,625,021</u>	<u>\$5,930,234</u>	<u>\$137,132</u>	<u>\$234,195</u>	<u>\$603,312</u>	<u>\$18,504,463</u>	<u>\$37,008,927</u>

2013 Biennium													
Agency	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total	Biennial Cost
Annual Allocation Rate (Cost / SF)	\$0.92	\$1.53	\$2.20	\$3.70	\$2.24	\$4.29	\$6.35	\$1.42	\$0.91	\$0.84	\$0.89	\$2.03	\$4.05
Board of Education	46,729	8,584	0	0	20,303	0	0	75,730	2,740	34,720	0	331,107	\$662,214
Administration	0	0	0	0	0	455,715	1,996,859	1,209,449	6,484	10,026	41,023	2,714,040	5,428,080
Agriculture	0	0	0	0	17,653	0	0	0	0	0	0	15,983	31,967
Corrections	0	32,911	31,619	2,504,346	0	0	0	107,869	13,264	4,867	69,198	1,794,533	3,589,066
Military Affairs	0	0	0	0	0	0	0	592,194	0	0	81,606	1,031,867	2,063,734
Natural Resources and Conservation	0	0	0	0	0	0	0	106,886	0	0	25,167	209,882	419,764
Public Health and Human Services	23,847	44,490	662,167	56,786	0	0	0	144,302	15,184	119,064	198,343	1,728,022	3,456,043
Revenue	0	0	0	0	0	0	0	0	0	0	82,119	185,976	371,951
Justice	8,050	21,450	4,445	0	0	0	0	25,981	0	38,347	0	180,022	360,045
Montana State University	106,431	0	0	0	2,474,591	1,162,226	606,306	1,934,298	31,347	28,202	97,622	6,343,850	12,687,700
University of Montana	<u>39,574</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,968,185</u>	<u>0</u>	<u>231,146</u>	<u>2,206,336</u>	<u>79,046</u>	<u>17,641</u>	<u>56,335</u>	<u>5,444,521</u>	<u>10,889,042</u>
Total	<u>\$224,630</u>	<u>\$107,435</u>	<u>\$698,230</u>	<u>\$2,561,132</u>	<u>\$4,480,732</u>	<u>\$1,617,940</u>	<u>\$2,834,311</u>	<u>\$6,403,045</u>	<u>\$148,066</u>	<u>\$252,867</u>	<u>\$651,414</u>	<u>\$19,979,802</u>	<u>\$39,959,605</u>

Figure 2 (cont.)

2015 Biennium														
Agency	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total	Biennial Cost	
Annual Allocation Rate (Cost / SF)	\$0.99	\$1.65	\$2.38	\$4.00	\$2.42	\$4.63	\$6.86	\$1.53	\$0.99	\$0.91	\$0.97	\$2.19	\$4.38	
Board of Education	50,454	9,269	0	0	21,922	0	0	81,768	2,958	37,488	0	357,506	\$715,011	
Administration	0	0	0	0	0	492,048	2,156,067	1,305,877	7,001	10,826	44,294	2,930,427	5,860,854	
Agriculture	0	0	0	0	19,061	0	0	0	0	0	0	17,258	34,516	
Corrections	0	35,535	34,140	2,704,015	0	0	0	116,469	14,322	5,255	74,715	1,937,609	3,875,217	
Military Affairs	0	0	0	0	0	0	0	639,409	0	0	88,112	1,114,137	2,228,273	
Natural Resources and Conservation	0	0	0	0	0	0	0	115,408	0	0	27,173	226,615	453,231	
Public Health and Human Services	25,748	48,037	714,961	61,313	0	0	0	155,807	16,395	128,557	214,157	1,865,795	3,731,589	
Revenue	0	0	0	0	0	0	0	0	0	0	88,666	200,803	401,606	
Justice	8,692	23,160	4,799	0	0	0	0	28,052	0	41,404	0	194,375	388,750	
Montana State University	114,916	0	0	0	2,671,887	1,254,889	654,646	2,088,517	33,846	30,451	105,405	6,849,638	13,699,275	
University of Montana	42,730	0	0	0	2,125,106	0	249,575	2,382,244	85,348	19,047	60,826	5,878,606	11,757,212	
Total	\$242,540	\$116,001	\$753,900	\$2,765,328	\$4,837,975	\$1,746,937	\$3,060,287	\$6,913,552	\$159,871	\$273,028	\$703,350	\$21,572,768	\$43,145,536	

2017 Biennium														
Agency	AF	D	HN	J	LA-B	LA-H	MU	O	PL	R	ST	Total	Biennial Cost	
Annual Allocation Rate (Cost / SF)	\$1.07	\$1.79	\$2.57	\$4.32	\$2.61	\$5.00	\$7.40	\$1.65	\$1.06	\$0.98	\$1.04	\$2.36	\$4.72	
Board of Education	54,477	10,008	0	0	23,669	0	0	88,287	3,194	40,477	0	386,009	\$772,019	
Administration	0	0	0	0	0	531,279	2,327,967	1,409,993	7,559	11,689	47,826	3,164,066	6,328,133	
Agriculture	0	0	0	0	20,580	0	0	0	0	0	0	18,634	37,267	
Corrections	0	38,369	36,861	2,919,603	0	0	0	125,755	15,464	5,674	80,672	2,092,092	4,184,184	
Military Affairs	0	0	0	0	0	0	0	690,389	0	0	95,137	1,202,966	2,405,931	
Natural Resources and Conservation	0	0	0	0	0	0	0	124,609	0	0	29,340	244,683	489,366	
Public Health and Human Services	27,801	51,867	771,964	66,202	0	0	0	168,229	17,702	138,807	231,232	2,014,552	4,029,105	
Revenue	0	0	0	0	0	0	0	0	0	0	95,736	216,813	433,626	
Justice	9,385	25,006	5,182	0	0	0	0	30,289	0	44,705	0	209,873	419,745	
Montana State University	124,078	0	0	0	2,884,913	1,354,939	706,840	2,255,032	36,545	32,879	113,809	7,395,751	14,791,502	
University of Montana	46,136	0	0	0	2,294,538	0	269,473	2,572,178	92,153	20,566	65,676	6,347,300	12,694,601	
Total	\$261,877	\$125,249	\$814,007	\$2,985,804	\$5,223,701	\$1,886,218	\$3,304,280	\$7,464,761	\$172,617	\$294,796	\$759,427	\$23,292,739	\$46,585,478	

Figure 3

Future Maintenance Trust with \$30 Million OTO Funds and 1% of Projects Administered by A&E

(earnings to reduce backlog of deferred maintenance backlog)

FY	Corpus	Future Funding Biennial Deposit - by Surcharge	Total Corpus	Interest Earnings	Annual Corpus with Interest	Interest Use	New Corpus
2008	\$30,000,000	\$0	\$30,000,000	6.12%	\$31,836,000		\$31,836,000
2009	31,836,000	388,440	32,224,440	6.12%	34,196,575		34,196,575
2010	34,196,575	0	34,196,575	6.12%	36,289,406	4,008,065	32,281,341
2011	32,281,341	447,636	32,728,976	6.12%	34,731,990		34,731,990
2012	34,731,990	0	34,731,990	6.12%	36,857,587	4,118,622	32,738,965
2013	32,738,965	476,126	33,215,091	6.12%	35,247,855		35,247,855
2014	35,247,855	0	35,247,855	6.12%	37,405,024	4,199,453	33,205,571
2015	33,205,571	504,230	33,709,801	6.12%	35,772,841		35,772,841
2016	35,772,841	0	35,772,841	6.12%	37,962,139	4,280,911	33,681,228
2017	33,681,228	534,755	34,215,983	6.12%	36,310,001		36,310,001

Assumptions:

\$30,000,000 One time only money deposited into a LRBP future maintenance trust

1.00% Biennial deposits of 1 percent of the major maintenance projects administered by A&E and funded through rental surcharge

* All projects construction/maintenance projects administered by A&E are included

3.91% Average non-residential building inflation applied as growth rate for bonded program

* One percent applied as a project cost and bond proceeds can be appropriated

6.12% Average Interest Earned over past five years on the trust fund bond pool

90% of interest earnings used each biennium, withdrawn at end of prior biennium.

*for example: interest earnings for the 2011 biennium withdrawn from trust at beginning of FY 2010

Figure 4
Long-Range Building Program Account (05007)

Fund Balance Projections for Five Biennia

Biennium	2009	2011	2013	2015	2017
Beginning Fund Balance	\$0	\$0	\$0	\$0	\$0
LRBP Revenues:					
Cigarette Earnings	\$3,548,028	\$3,365,929	\$3,193,176	\$3,029,290	\$2,873,815
Coal Tax Earnings	7,650,000	7,445,000	7,240,000	7,035,000	6,830,000
*Agency Based Rental Surcharge	34,276,132	37,008,927	39,959,605	43,145,536	46,585,478
*Biennial Endowment Trust Interest	0	4,008,065	4,118,622	4,199,453	4,280,911
General Fund Debt Service Transfer	1,330,000	1,330,000	1,330,000	1,330,000	1,330,000
Energy Conservation Savings	159,741	159,741	159,741	159,741	159,741
Supervisory Fees and Interest Earnings	<u>325,767</u>	<u>351,740</u>	<u>379,784</u>	<u>410,064</u>	<u>442,757</u>
Total LRBP Revenues:	\$47,289,668	\$53,669,402	\$56,380,928	\$59,309,083	\$62,502,702
LRBP Expenditures:					
Program Administration	(\$2,727,159)	(\$2,855,335)	(\$2,989,536)	(\$3,131,121)	(\$3,279,413)
Debt Service Costs	(5,754,506)	(5,851,823)	(5,578,400)	(5,582,739)	(5,603,878)
Deposits to Endowment Trust	(342,761)	(370,089)	(399,596)	(431,455)	(465,855)
Deferred maintenance backlog reduction	0	(4,008,065)	(4,118,622)	(4,199,453)	(4,280,911)
Total LRBP Expenditures:	(\$8,824,426)	(\$13,085,313)	(\$13,086,154)	(\$13,344,769)	(\$13,630,058)
Total Available Project Funds:	\$38,465,242	\$40,584,089	\$43,294,773	\$45,964,314	\$48,872,645
Agency Major Maintenance	<u>\$33,933,370</u>	<u>\$36,638,838</u>	<u>\$39,560,008</u>	<u>\$42,714,081</u>	<u>\$46,119,624</u>
Total Funds Available to Reduce Deferred Maintenance Backlog	<u>\$4,531,872</u>	<u>\$3,945,252</u>	<u>\$3,734,765</u>	<u>\$3,250,233</u>	<u>\$2,753,021</u>

Assumptions:

* New funding proposal

The projects of all LRBP eligible buildings are administered by the LRBP

All agency appropriations are expended

LRBP Cigarette tax revenues will continue to flow into the LRBP account at a declining rate of 2.6 percent annually

Interest earnings are based on the previous assumptions and earnings will not be drawn until the start of the 2011 biennium

Coal tax revenues decline at a rate of \$100,000 per year

Coal tax distributions will continue to flow into the Capital projects account until debt service is paid in full

General fund debt service payments continue until debt service is paid in full

Energy conservation savings are equal to the projected deposits of the 2005 biennium

Supervisory fees increase at the same rate as non-residential building construction, 3.91% annually

No additional FYI will be added to the LRBP

Administrative costs increase at a rate of 4.7% per biennium

Total available project funds are all revenues less all expenditures

Agency major maintenance is reduced by 1% cost of the future maintenance endowment trust appropriation