

21st Century School Facilities Commission

Funding Subcommittee

Nancy K. Kopp, Chair



Agenda

December 4, 2017

1:00 p.m.

House Office Building, Room 120

Annapolis, Maryland

Work Session

Larry Hogan
Governor

Boyd K. Rutherford
Lt. Governor



Ellington E. Churchill, Jr.
Secretary

MARYLAND DEPARTMENT OF GENERAL SERVICES

FACILITIES OPERATIONS & MAINTENANCE • FACILITIES PLANNING, DESIGN, CONSTRUCTION & ENERGY
PROCUREMENT & LOGISTICS • REAL ESTATE

November 28, 2017

Martin Knott
Chair
21st Century Schools Facilities Commission
c/o Department of Legislative Services
Legislative Services Building
90 State Circle
Annapolis, MD 21401

Chair Knott:

The Department of General Services (DGS) has reviewed the recommendations made by the Funding Subcommittee and the Process, Procedures, and Educational Specifications Subcommittee, dated November 14, 2017. DGS provides the attached responses to the recommendations, related to DGS's functions for the State of Maryland's Public School Construction Program.

Should you have any questions, do not hesitate to contact me at 410-767-4960 or Ellington.Churchill@maryland.gov.

Sincerely,

A handwritten signature in blue ink, reading "Ellington Churchill, Jr.", with a large, stylized flourish at the end.

Ellington Churchill, Jr.
Secretary

DGS Responses to the Knott Commission's Subcommittee Recommendations

The Department of General Services (DGS) Secretary is a member of the Inter-Agency Committee (IAC) for school construction. DGS provides technical support to the IAC and Maryland's Public School Construction Program (PSCP). The support for these programs is provided from the DGS Public School and Community College Construction Unit within the Office of Facilities Planning, Design & Construction. This unit also provides technical support for State funded design & construction at Community Colleges. The IAC is also supported by the Department of Planning and the Department of Education. The division of labor between the units is delineated within the PSCP Administrative Procedures Guide, based on requirements within Statute and COMAR. DGS is responsible for the technical review of design documents and an administrative review of contract documents associated with these design documents.

DGS VALUE ADD

DGS provides a consistent, unbiased view of the technical components of design & construction for the PSCP & the State. The team of technical experts understand what building systems are necessary, what building systems are eligible with State funding, and what modifications should be made to ensure these systems are adequately designed per code and State standards. DGS provides a centralization of this review process, thus ensuring errors identified in one design can be recognized in others.

In addition to the technical review, DGS provides an administrative compliance review of State MBE requirements, State Prevailing Wage Rate requirements, solar energy analysis and the Buy American Steel Act. This too provides a centralized, unbiased review of documents to ensure compliance with State standards.

DGS staff work with the Department of Planning during the planning review for new schools, DGS verifies that renovations using State funding are not pending on facilities planed for demolition and replacement. During the IAC approval process for building system renovations, such as roofs and heating systems, DGS provides technical expertise on system prioritization and coordination. DGS outsources large review projects, roughly 25 projects per year. Outsourcing adds additional time to the process due to procurement requirements. In house, DGS performs roughly 175 reviews annually. If these reviews were outsourced, the division would still be needed to process the outsourcing and ensure compliance of the outsourced reviews.

Over the last 3 years, DGS has been assessing their portion of this program to identify efficiencies and to better align DGS core competencies to add more value to the Local Education Authorities (LEAs). Within the last year, DGS has begun to move the division forward making internal changes, where needed. Additional changes have been identified, both internal and external, including potential regulation or legislative proposals. Finally DGS is working on changing the culture within the public school construction unit. Our end goal remains to reduce overall submission review and response to the LEA's within 2-3weeks. Change is always challenging, but staff accountability is paramount for our collective processes to work effectively.

DGS Responses to the Knott Commission's Subcommittee Recommendations

One year ago, DGS developed plans to improve interactions with the IAC and LEAs	
Process reform	<ul style="list-style-type: none">• To reduce timelines, DGS has moved to electronic submissions and has made procurement changes for outsourcing; and staffed technical disciplines (mechanical/electrical/ structural/civil/ architectural).• DGS is simplifying the change order process and identifying times for schools to receive expedited reviews.• Separation of the technical and administrative reviews conducted by DGS, to expedite receipt of DGS comments to the LEAs
Greater transparency	<ul style="list-style-type: none">• DGS has increased communication with LEAs and has offered expedited reviews on a case-by-case basis.• DGS is developing an online portal that includes sample documentation of good submissions and the opportunity for LEAs to review the status of their projects.
Regulatory	<ul style="list-style-type: none">• DGS is creating a process to make it possible for school systems to conduct their own reviews. DGS agrees that regulatory changes are necessary to eliminate change order reviews.

DGS Responses to the Knott Commission's Subcommittee Recommendations

PP&E Subcommittee Recommendations

Development and State Approval of Projects

Recommendation / Questions

DGS Response

3. Maintain a role for the State to review and approve State funded projects, but streamline the process to minimize unnecessary delays:	
a. Eliminate required Department of General Services (DGS) review and IAC approval of design documents, construction documents, and change orders for both major construction and systemic renovation projects.	Disagree with the recommendation. Voluntary review ultimately will create voluntary compliance with State Requirements. In addition to reviewing the blueprints for compliance with design & construction codes, DGS conducts review of MBE procedures, Prevailing Wage, Buy American Steel and Ineligible items for State Funds. These additional reviews are done with the blueprint review submissions for both major construction and systemic renovation projects.
b. Allow local school systems to request that DGS review and provide feedback on their design and construction documents on a voluntary basis.	<p>Some Local Education Authorities (LEAs) are subject to local government code review authorities, some perform this code review in-house for design & construction and some rely solely on the DGS review. Local Government code reviews do not include the additional reviews of State requirements for MBE, Prevailing Wage, Buy American Steel or Ineligible items.</p> <p>Creating an exemption procedure for certain portions of the review process if the LEA can provide documentation that the process is redundant would reduce the risk to the State by ensuring compliance with State funding requirements and achieve the goal of streamlining the process.</p> <p>DGS agrees with elimination of DGS change order review. The volume of change order requests greatly supersedes the change order funding available.</p>

DGS Responses to the Knott Commission's Subcommittee Recommendations

	<p>At a minimum, once a project has exceeded the available change order funding, the DGS change order reviews should cease.</p> <p>Change Orders are typically submitted by LEAs to DGS in bulk at the conclusion of construction. DGS's review and approval process does not impact the actual construction, the process is for reimbursement to the LEA, if there are items eligible for State funds and if there are funds remaining. Since 2012, DGS has reviewed 10,553 change orders, 99% of these change orders were declined for State Funding.</p>
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DGS Responses to the Knott Commission's Subcommittee Recommendations

Funding Subcommittee

Recommendation / Questions

DGS Response

5. Eliminate the 2.5% withholding for contingencies from the State allocation (related to Process Subcommittee recommendation to eliminate DGS review of change orders) but require LEAs to maintain a contingency to address unanticipated construction costs above the State allocation.	DGS agrees that the change order funding is inadequate in comparison to the volume of change orders from LEAs. LEAs currently fund over 99% of change orders for public school construction projects.
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IAC Responses to Knott Commission's Funding Subcommittee Recommendations

Overall IAC Recommendations:

- I. Transform the current grant management with regulatory controls process into a modern facilities portfolio management process that supports best practices to ensure that all PK-12 children are housed in educationally sufficient school facilities for the delivery of State required educational programs in healthy and safe environments.
- II. Provide the staffing and management tools necessary for transparent support and administration of all processes deemed prudent for achieving the expected provision and maintenance of PK-12 school facilities.
- III. Provide a dedicated funding source for the reliable and consistent administration of facility management programs, which does not compete with the general fund, and that preserves and protects statewide capital investments, including a facilities portfolio of 50-year expected life assets, valued at more than \$50 billion, that houses 885,820 children.
- IV. Establish a uniform measure of a school facility's educational sufficiency condition and longitudinally compare each school against all others and the statewide average.
- V. Establish a uniform expected life-span for each major facility building system (e.g. roofs, HVAC, interior finishes, etc.) and longitudinally measure and track actual life that each building system achieves against its expected life.
- VI. Revise the maintenance effectiveness assessment program to measure capability of management systems. Considerations include the comprehensiveness of building systems inventory, automatic generation of preventative maintenance work orders, emergent maintenance tracking, work order aging reports, documented prioritization of life-safety, health, and building system issues. Chronic issues should be included in the Educational Facilities Master Plan (EFMP) capital needs for leaderships' knowledge and consideration.
- VII. Continuously review the need and value of each IAC administrative process and implement a cloud-based business process management system to monitor expected process performance of each necessary task for accountability and data driven improvement.
- VIII. Allocate available resources to maximize equitable access to educationally sufficient facilities for all of Maryland's school-age children and to improve the statewide average school facilities educational sufficiency.
- IX. Longitudinally track and report key indicators of program performance and periodically recommend program revisions to the BPW, the General Assembly, and the Governor which will safeguard that each PK-12 school is educationally sufficient.
- X. Consider the creation of a permanent intersession PK-12 school facilities task force composed of a balanced membership of educators, legislators, agency secretaries, and public members, that meet 2-4 times annually to review IAC program(s) performance, and if necessary, to make recommendations for improvement.

Funding Subcommittee

Recommendation / Questions	IAC Response
<p>1. Conduct a statewide facilities assessment using an integrated data system that will enable LEAs to regularly assess school facilities in a uniform manner statewide. The assessment and integrated data system should be done by an outside vendor initially, with the State and LEAs continually updating it. (Initial estimates for the cost of one-time assessment <i>only</i> is \$3.5 million.) The LEAs should work with the State to identify the data elements that should be maintained at the State level, utilizing existing reporting sources such as the Educational Facilities Master Plan for data reporting to the extent possible.</p>	<p>This is in keeping with current COMAR 13A.01.02.04 that requires a statewide assessment every four years; yet, because of lack of dedicated funding, it was only performed in 2003. Facilities condition assessments have a shelf life of approximately 4 years, and are necessary to know both the overall and specific capital needs. The initial estimate for a contracted statewide assessment includes a database that can then be maintained with a permanent 8-10 member professional IAC assessment team to assess physical and educational sufficiency of each school facility on a 3-4 year cycle. LEAs should also be required to input all facilities modifications over \$300K. It is encouraged that this assessment advance quickly. See IAC recommendations I, II, III, and IV.</p>
<p><i>Q1. Should/how should the results of the assessment be incorporated into project funding decisions?</i></p>	<p>Yes. Some portion of available funding should be allocated for this use. The law of averages will provide greatest investment efficiency of this use towards improving the statewide educational facilities average condition. The more uniform the conditions, the more our school facilities portfolio will improve. See IAC recommendations I and VIII.</p>
<p>2. The State should set a new funding goal and counties must continue to provide their local match. The State's short-term funding goal should be at least the current capital funding level for school construction (\$342.5 million in fiscal 2018). Although this is not sufficient to address school construction needs, it is critical to have up-to-date information upon which to base the goal. Once the initial school facility assessment is completed, the results should be used to</p>	<p>Agree with the short-term funding goal. However, both the State and the Counties should set funding goals based upon an agreed Statewide average facilities condition outcome goal to be achieved by a specific future year and inclusive of estimated construction cost inflation. Funding goals should be regularly reviewed against facilities assessment reporting. See IAC recommendations I, VIII, IX, and X.</p>

Funding Subcommittee

Recommendation / Questions	IAC Response
develop a long-term school construction funding goal.	
3. The State-Local Cost Share formula should continue to favor jurisdictions with limited resources to support school construction. After reviewing the cost share formula as revised by the IAC in fall 2017, the formula appears to include all of the appropriate components. However, a common definition of local PAYGO included in the local school construction effort calculation should be developed so that all 24 counties are reporting comparable data. In addition, the cost share formula should be updated every two years (instead of three years) to reflect changes in local conditions.	Agree with recommendation except that the cost share formula should be calculated annually and upon a three-year rolling average of calculation data. This will dampen swings, ensure funding equity, and will provide consistent longitudinal patterns so that LEAs can make reasonable projections a few years into the future what their State funding participation will be for planned projects.
4. Review and update eligible and ineligible costs in light of changing circumstances (<i>e.g.</i> , projectors are ineligible but many classrooms now have projectors permanently mounted to ceilings) within existing State policy that requires eligible costs to have a useful life of at least 15 years. Items that do not have a 15 year useful life should not be eligible for State funding.	Agree with recommendation. DBM can provide guidance based on standards applied to State agency and higher education projects. The Office of Capital Budgeting has provided guidance on this and this is available on the DBM website. http://dbm.maryland.gov/budget/Documents/capbudget/CapEquipGuidelines.pdf The IAC can build from these and provide eligible cost guidance specifics for PK-12 school facilities. See IAC recommendations VIII.

Funding Subcommittee

Recommendation / Questions	IAC Response
<i>Q4a. With limited resources, any significant expansion of eligible costs may mean fewer projects receive funding in a given year.</i>	Agree that funding is limited. Funding should be allocated to produce greatest educational sufficiency and furniture and fixtures can both support the right-sizing of schools for lower total cost of ownership and support greater learning flexibility. See IAC recommendations VIII.
<i>Q4b. Should any costs be removed from eligibility? Perhaps systemic renovations (i.e., capital maintenance)?</i>	Yes. Major repair, alteration, and replacement of building systems, equipment, and components that will sustain or extend the useful life of the entire facility campus (school), but are insufficient to renew the facility should be considered required local stewardship. The State can assist in providing estimated need projections (see IAC recommendations II and V), but final decisions should be local. The State should participate on a case-by-case basis in maintenance capital projects and only when there is not adequate local capacity to perform the required work. This could be an advance from a revolving fund that is repaid, and is provided in the form of partial or full grants with IAC recommendation and BPW approval. These projects should be considered emergent needs that are outside of any normal funding cycles. See IAC recommendations VIII.
5. Eliminate the 2.5% withholding for contingencies from the State allocation (related to Process Subcommittee recommendation to eliminate DGS review of change orders) but require LEAs to maintain a contingency to address unanticipated construction costs above the State allocation.	Agree with recommendation.
6. Eliminate the requirement that LEAs submit future planning and construction project requests in the CIP beyond the upcoming fiscal year.	<p>Two counter opinions to this recommendation:</p> <p>A. Disagree with recommendation. This is a useful tool to evaluate consistency with educational facilities master plans, to identify future areas for conflict or coordination at the same facility. An example is a school that may be requesting a roof but is showing a planning request for a renovation project four years out.</p> <p>B. Agree in principle with the recommendation provided that educational facilities masterplans (EFMP) follow a specific format template and are updated</p>

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Recommendation / Questions	IAC Response
	and submitted electronically into an IAC business management system before any construction project request. Projects will be projected five years out in the EFMP and should be the same as those currently required in CIP application. See IAC recommendations I and VII.
7. The State should provide technical assistance and help facilitate P3s, such as developing template lease agreements between developers and school systems.	Agree in principle. In addition to the development of standard template lease agreements, the IAC would need capacity to provide the ongoing support to the LEAs in administering the agreements. The DGS Office of Real Estate is an entity with current experience in this area. See IAC recommendations II, III, VIII, and X.
8. Preventative maintenance is critical – there is a need to require LEAs to perform required regular maintenance and for the State to collect and monitor performance data through a comprehensive maintenance management system (CMMS) that is integrated with the facility assessment information system.	Agree with recommendation. See IAC recommendations II, III, V, VI, VIII, and X.
9. The State should encourage and provide technical support for agreements between and among LEAs and county governments, including regional partnerships, to improve efficiencies.	Agree with recommendation. See IAC recommendations II, III, IX and X.
10. The State should explore the possibility of creating a school construction authority that issues appropriation-backed or revenue bonds with terms longer than 15 years to accelerate State school construction funding. Alternative funding such as a dedicated revenue source or perhaps combining State and local revenue should be considered.	Partial agreement with recommendation. An authority, and a dedicated funding source, are worth exploring. A longer debt term ultimately leads to higher overall payments. A revolving fund discussed in the item #4 response for emergent needs could be used to advance forward funding for projects. The fund could also provide as-needed partial or full grants to LEAs lacking capacity for repayment with IAC recommendation and BPW approval. See IAC recommendations I and VIII.
<i>Q10. GO bond debt is typically the least expensive option for the State. Moving to</i>	Agreed. See IAC recommendations I and VIII.

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Recommendation / Questions	IAC Response
<p><i>appropriation or revenue backed bonds increases the cost of debt, which may be offset by completing projects sooner and avoiding the inflationary costs.</i></p>	
<p>11. The State should explore creating a facility renewal fund equal to 2% of the value of the facility assets or should require LEAs to create such a fund.</p>	<p>This level of funding will not renew facilities, but is in line with a 2% industry standard (1% for alterations required by programming or population changes and 1% for systemic replacements, routine maintenance, and emergency maintenance) for work that is required to sustain or extend the useful life of existing school facilities. See the response for Q4b. This stewardship cost should be valued and funded with local effort and LEAs can benefit with more granular decision making without State regulation. The State can support planning with accurate and impartial facilities condition information.</p> <p>The State's capacity should be preserved to assist with large allocations that renew or replace existing facilities, and to build new where growth requires a new school. This spending will have the greatest bang-for-the-buck towards improving statewide condition averages. Industry standard for capital renewal (new, renewal, and replacement projects) is 2% of the current replacement value of the portfolio based upon an average 50-year lifespan for each facility. This level of funding supports status-quo facility conditions. Improving facility conditions requires additional spending. See IAC recommendation VII.</p> <p>Agree that a dedicated funding source would help, however two percent may be insufficient for some LEAs with poor conditions and excessive for others. There may be a need for additional State assistance to certain LEAs to maintain a 2% maintenance capital investment. See the response for Q4b regarding a revolving fund that could supplement capacity for maintenance capital. See IAC recommendations II, V, VI, and VII.</p>
<p><i>Q11. Should the State provide an incentive for LEAs to fund facility renewal?</i></p>	<p>Yes. If an LEA maintains existing facilities and extends the average life of building systems past expected, each percentage point average extension could be matched with an additional percentage of State participation in new, renewal,</p>

Funding Subcommittee

Recommendation / Questions	IAC Response
	and replacement projects. This incentivizes good stewardship. See IAC recommendations I, V and VII.
<p>12. Consider whether an alternative methodology to the current square footage allocations that are used to calculate the State maximum allowable square foot for a project could result in more efficient use of space in school buildings. The current space allocations have not been updated to reflect new space guidelines. If the current methodology is retained, consider regional figures rather than one statewide amount. (PPE Subcommittee also considered this issue.)</p>	<p>Agree with recommendation except for consideration of regional figures. The IAC staff have begun the compilation of all existing space guidelines with the purpose of transparency, elimination of redundancy and conflicts, and a logical justification for educational space requirements that will include baseline space requirements for all grades and student population counts and additives for variable program requirements. It is anticipated that a draft of the PK-12 school facilities sufficiency guidelines will be made available to begin feedback process early in 2018. This will be a companion document to the draft sufficiency standards that are intended for use to assess existing facilities for educational sufficiency (or lack of) and are currently in their second revision. Draft standards are available for comment on the PSCP website at www.pscp.state.md.us.</p>
<p>13. Explore the feasibility of regional (multi-district) school construction projects, <i>e.g.</i> regional Career and Technical Education high schools and develop mechanisms and incentives to provide State funding.</p>	<p>Agree with the concept and urge continuing discussion, provided that there is no increase in overall square footage, and therefore ownership cost, of Maryland school facilities. Study should include standard curriculums and graduation goals developed with business partners and should consider transportation logistics.</p>
<p>14. The State should encourage the maximum use of energy savings performance contracts to improve energy efficiency in new and renovated schools, perhaps by pooling LEA projects and even local projects to maximize the savings. Over time, the operating savings from lower energy costs provides a new revenue source that may be monetized (perhaps to address item 10).</p>	<p>Agree with recommendation. The benefits to an LEA and local government are clear enough and energy performance contracts (EPCs) are in use now. The weakness is having a good agreement (see #7 response). Standard template EPC agreements, real-time uniform utility monitoring, and best practices based upon performance would help ensure expected savings. Real-time utility monitoring allows the facility to become a tool for STEM learning opportunities. See IAC recommendations II and III.</p>

Funding Subcommittee

Recommendation / Questions	IAC Response
<i>Q14. What incentives if any should the State provide for LEAs to improve energy efficiency?</i>	None are required as LEAs benefit from State support, savings that equate to additional funding, and potential for STEM learning support tools.

BALTIMORE CITY PUBLIC SCHOOLS

Catherine E. Pugh
Mayor, City of Baltimore

Cheryl A. Casciani
*Chair, Baltimore City Board of
School Commissioners*

Dr. Sonja Brookins Santelises
Chief Executive Officer

November 30, 2017

Mr. Martin Knott, Chair
21st Century School Facilities Commission
Room 120, Appropriations Committee
6 Bladen Street
Annapolis, MD 21401

Dear Mr. Knott,

On behalf of the students and families that comprise the Baltimore City Public Schools, we thank you for the time and attention that you and your fellow members have devoted to the 21st Century School Facilities Commission (Knott Commission). The critical work that you have conducted over the past two years will undoubtedly shape Maryland's school construction process for years to come.

While we are encouraged by the majority of the subcommittee recommendations that were presented to the full Commission at the November 14 meeting, there are some that cause serious concern. Consequently, in preparation for the Commission's final vote in December, we respectfully ask for consideration of City Schools' perspective on several key areas as they relate to the recommendations presented thus far. Specifically:

- Potential elimination of systemic renovations from CIP funding
- General notion that the current cost share formula includes all appropriate components
- Lack of recommendation regarding the IAC's awarding of partial funding
- Lack of recommendation regarding contingency reserve funding and the implications of recycling funds

Potential elimination of systemic renovations from CIP funding

City Schools is deeply concerned by item #4b of the Funding Subcommittee's recommendations document, which questions the removal of systemic renovations from CIP eligibility. We are equally concerned by the discussion that took place at the November 8 meeting of the IAC, in which members deliberated limiting future CIP funding to major projects and life safety systemics only.

A change of this magnitude would be detrimental to City Schools, especially given that State management of the CIP has provided support to LEAs in both new and renovated facilities as well as systemics since 1987. As a system that grapples with limited local contributions, it is simply not feasible for the District to support its systemic renovations in isolation of State support.

A key purpose of the State's CIP is for the program to serve as an equalizer between wealthier LEAs with greater capacity to contribute to capital projects and jurisdictions like Baltimore City, where capacity is limited by a significantly lower tax base. The State's potential move to shift the burden of systemic projects – which represent over 80% of the District's CIP – to be supported solely by the local contribution (or in our case, the District's general fund) would be harmful on many fronts. Cuts to the general fund would lead to the elimination of salaried positions within our Operations Department – the very positions that are key to managing CIP projects. In addition, if our \$17M contribution from Baltimore City were to be

allocated entirely to systemics, this would leave no additional funds to support major projects; nor would it supply enough funds to cover the number of large systemic replacements needed annually.

It should also be noted that we entered into the 21st Century Buildings Program with the City, State and the Maryland Stadium Authority because we lack the resources to fund major construction and renovations on our own. The State allowed the three-way partnership in recognition of the fact that we are severely limited by our local funding, which generally only allows for upgrading and renovation of systemics (i.e. roofs, HVAC) and occasional major renovations. Without this program, we would be unable to address a large number of aging facilities with the level of construction or renovation needed in the district. If systemics become ineligible for CIP funding it will place us at a disadvantage in maintaining our building stock.

We encourage the Commission to fully consider the financial context in which the District operates to support its aging facilities, and to vote against any recommendation to remove systemics.

General notion that the current cost share formula includes all appropriate components

The Funding Subcommittee notes in item #3 of its recommendations document that “after reviewing the cost share formula as revised by the IAC in fall 2017, the formula appears to include all of the appropriate components”. City Schools has several concerns regarding this statement. While the components of the State-Local Cost Share formula may be generally appropriate, City Schools capital debt is not currently included. As the only school system in the state with the ability to issue debt, we feel strongly there should be some formal recognition of this factor in the formula.

In addition, it should be noted that serious questions remain regarding the wealth calculation that is used for school construction. As the Kirwan Commission proceeds with its work, it appears likely that modifications will be made to the wealth calculation so that the State-Local Cost Share formula is better able to reflect true relative wealth. We encourage the Knott Commission to include a statement in its final report that acknowledges this reality.

Lack of recommendation re: the IAC’s awarding of partial funding

As noted in the letter we submitted to the Knott Commission at this time last year, City Schools has long been negatively impacted by historical partial funding of projects, a practice that has led to increased numbers of projects being rescinded, and ultimately resulting in high balances in Baltimore City’s contingency fund.

Partially funded projects impact the district in two ways. First, due to a low tax base and limited local funding, the district does not have the ability to forward fund projects with a local contribution of \$17 million each year. In addition, the IAC’s approach to partial funding has not been consistent – funding projects over one, two or three years. Given the limitations of the local contribution, City Schools cannot begin projects until all funding is committed. The lack of certainty regarding when projects will receive full funding impacts the district’s ability to include adequate escalation rates. Unable to fund financial gaps that result from the escalation rates of partially funded projects, City Schools must rescind projects to be rebid with new cost estimates.

The implications of the large volume of rescinded projects due to past partial funding are demonstrated below:

- In FY17, approximately 60% of our state allocation for systemic projects, representing 18 of 27 of those projects, were partially funded. With changing market conditions over time, multi-year funding leads to a time lag between when project costs are initially estimated and submitted to BPW for approval and when City Schools receives the balance of funds for projects from BPW; as a result, the approved amount is below the final bid cost.
- As an example, of the 18 projects partially funded in FY 17 with \$18.2M, four projects representing \$10.5M had to be rescinded due to increased costs and bids higher than the amount approved for projects.

For all of these reasons, we respectfully encourage the Knott Commission to eliminate the partial funding of projects in its final report, or restrict the partial funding of projects to major building replacement projects only.

Lack of recommendation re: contingency reserve funding and the implications of recycling funds

Again as noted in our letter submitted to the Knott Commission last November, when projects must be rescinded, the money is to stay with the school district and be used to fund other eligible projects from that fiscal year's CIP. However, the IAC has historically used those reverted funds to fund projects in the school district's next fiscal year's CIP, as opposed to allowing the school district to use the money to fund other projects from the original fiscal year's CIP, leading to the funds essentially being double counted.

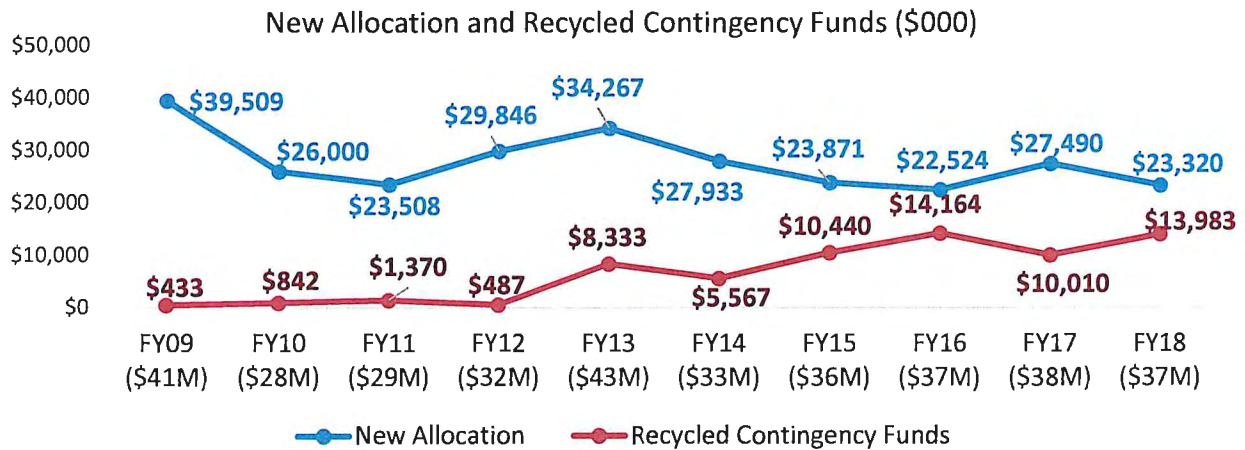
For example, if one project is rescinded in a fiscal year, those funds should then be allowed to fund a project that was eligible in that same fiscal year. However, the current reality is that in the next fiscal year, the reverted funds are now counted as part of the funds we are awarded in the next fiscal year. This would only make sense if City Schools received more funding equivalent to the rescinded project in the following year's CIP but instead the school system receives relatively the same amount each fiscal year.

As way of recent example, in summer 2017 City Schools had a balance of \$31M in our reserve contingency account due to recently rescinded projects that were partially funded or where there were contracting issues. On September 29, 2017 the IAC approved the recommendation to use \$20.5 million of the contingency funds for FY 18 projects. There remained \$10.5 million in the contingency when we applied for FY 19 CIP funds.

On November 14, 2017, we received notice that \$10.5 million of our FY 19 CIP allocation represents recycled contingency reserve funds. This means that of the \$23 million we received, \$10.5 million of our allocation is not new money. Recycling the funds places City Schools, again, at a disadvantage as we will not be able to fund prioritized projects. The use of contingency reserve funds to be used in the allocation for an upcoming CIP defeats the purpose of allowing districts to rescind, as the money should be reverted to other eligible projects in that year of the rescission.

As noted previously, the State's CIP is meant to serve as an equalizer between wealthier LEAs with greater capacity to contribute to capital projects and jurisdictions like Baltimore City, that lack the tax base and must support numerous public-related programs common to urban centers, to contribute to capital projects. Recycling funds reverted in past years, most of which is from projects rescinded due to City Schools' inability to forward fund projects, exacerbates rather than reduces the gap between affluent and less affluent LEAs.

Including recycled contingency funds in our CIP funding allocation directly decreases the amount of funding available to City Schools and has a negative impact on our ability to adequately fund capital projects. As demonstrated in the chart below, since FY 13 the district's annual allocation has increasingly been recycled from the contingency fund from prior years. As an example, in the last four years our total annual state allocation has been approximately \$37M, but the amount of newly allocated money has only ranged between \$23M and \$27M each year. The rest of the allocation has been derived from recycled contingency funds between \$10M and \$14M. Ultimately this increases the funds allocated to wealthier LEAs and penalizes high poverty jurisdictions like Baltimore City that do not have the capacity to forward fund projects.



As indicated in the above chart, the cumulative effect of recycling City Schools' reverted funds over the past 10 years represents a loss of approximately \$66 million, equivalent to a loss of nearly two years of CIP dollars. Also, our FY18 allocation of new dollars is 42% below the amount of new funding allocation we received ten years ago.

City Schools has brought this to your attention in the hope that you will support us by including a recommendation in the Knott Commission's final report to ensure that any reverted project funds be used to fund eligible CIP projects from the same fiscal year rather than be counted in the funding for the following fiscal year.

We appreciate your consideration and thank you for your continued support in addressing the capital needs of Baltimore City Schools. We are available to discuss the matters described in this letter in person and/or with Knott Commission staff at any time. If additional information is needed, please contact J. Keith Scroggins at 410-396-8722.

Sincerely,

Cheryl A. Casciani

Cheryl A. Casciani
Board Chair

Sonja B. Santelises

Sonja Brookins Santelises, Ed.D.
Chief Executive Officer

cc: 21st Century School Facilities Commission Members
Baltimore City Delegation Members
Rachel Hise

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ALTERNATIVE FINANCING FOR SCHOOL CONSTRUCTION PROJECTS: HISTORY, REGULATORY ENVIRONMENT, CONSTRAINTS, PROSPECTS

A report to the Finance Subcommittee, 21st Century School Facilities Commission

November 15, 2017 (based on a presentation of November 1, 2017)

Note: The topics covered in this brief summary are more fully developed in two reports by the IAC, "Meeting the Need for School Construction: Annual Report on the Status of Alternative Financing, Procurement, and Project Delivery for Maryland Public School Construction", dated October 3, 2011, and a supplement of the same title from September 13, 2013.¹

BACKGROUND: THE KOPP COMMISSION

In 2003, the Task Force to Study Public School Facilities, known as the Kopp Commission, conducted a statewide study of school facility adequacy. The study found that it would require \$3.85 billion to bring all schools in Maryland to the minimum standards that were identified by the Commission.

The Commission members recognized that to address this large building task, conventional funding would need to be supplemented with expanded financing tools. To this end, a sub-committee of the Commission explored:

- Public-private partnership (P3) models that had been used in Nova Scotia, Houston, Fairfax County, and other areas, particularly sale-leaseback and lease-leaseback approaches;
- The Oyster School project in Washington, DC, a prominent national example of how an under-valued property asset can be leveraged to secure a funding stream for replacement of an older school building;²
- Performance contracting, specifically energy performance contracting (EPC)

As a result of this research, the Commission's Report of February 2004 included recommendations to facilitate the use of alternative financing by school systems in Maryland. The omnibus Public School Facilities Act of 2004 included enabling provisions for alternative financing. Regulations were subsequently approved in October 2007 as COMAR 23.03.05.

In the 2004 to 2005 period, there was initially a good deal of interest in alternative financing from the private sector and a few of the local educational agencies (LEAs). Charles County Public Schools was interested in accelerating construction of a new elementary school without displacing any projects in the annual Capital Improvement Program (CIP); it found, however, that the alternative financing approach would not in fact accelerate the project, and the overall project cost would likely be higher than through conventional bond financing. Harford County Public Schools was interested in a land swap concept involving a property with commercial potential. In the end, neither LEA pursued these projects.

Following this initial wave, interest abated for a number of reasons:

- Alternative financing did not appear to offer schedule or cost advantages over conventional methods.
- Few LEAs had the internal capacity to develop the complex solicitations and contracts that are required for a public-private financing venture.

¹ The reports can be found at:

<http://msa.maryland.gov/megafile/msa/speccol/sc5300/sc5339/000113/014000/014074/unrestricted/20110898e.pdf>

[http://dlslibrary.state.md.us/publications/exec/iac/psc/sb787ch306hb1230ch307\(13\)\(2004\)_2013.pdf](http://dlslibrary.state.md.us/publications/exec/iac/psc/sb787ch306hb1230ch307(13)(2004)_2013.pdf)

² See http://www.esc-pau.fr/ppp/documents/featured_projects/usa_oyster_school.pdf for a succinct description of the project (United Nations Development Programme, Special Unit for South-South Cooperation)

- Potential vendors, including financial entities and large construction/project management firms, may have recognized that schools represent a difficult asset class. Under a sale-leaseback or lease-leaseback arrangement, if the owner defaults on the scheduled lease payment, the physical design and location of the typical school building means that it has less potential for repurposing than other asset classes, particularly office buildings. Also, under arrangements like the one used in Nova Scotia, in which the developer is responsible for a portion of the financing and expects to lease the school to various users as a source of revenue, the demand proved to be less than anticipated.
- LEA hesitation. As with new, untried building technologies or project delivery methods, LEAs require the proof of a valid pilot or prototype before taking on the risks of innovation. At that time, apart from projects like the Oyster School that enjoyed uniquely favorable circumstances, there were no successful and extensive models in the United States of schools built with alternative financing.

In the early 2000s, the IAC studied the Building Schools for the Future program in the United Kingdom and the school construction programs in Canada, particularly in Alberta. These programs used the design-build-finance-maintain-operate (DBFMO) alternative financing model, in which a private entity not only designs, builds, and finances the school facility, but also is assigned a certain portion of the maintenance and operational (M&O) responsibilities. The vendor's costs are compensated with an availability payment made by the LEA (or local authority in Britain) if the vendor maintains agreed standards of quality and responsiveness. Ownership of the facility may or may not be transferred to the private entity, as a matter of contract and local preference. Likewise, M&O responsibilities and risks can be partitioned according to local preferences as well as cost and risk considerations.³ The determination whether to use alternative financing is based on a "value-for-money" analysis that compares the cost, schedule and quality of the alternative financing approach to these same factors under conventional financing.

The IAC held a number of conferences and meetings on the subject with LEAs and financial teams that had been active in the UK and Canada, and explored some of the jurisdictional and organizational issues that would need to be addressed. Recognizing that the program could not move forward without active interest by one of the larger LEAs, the IAC did not pursue this path after around 2013.

REGULATIONS ON ALTERNATIVE FINANCING (COMAR 23.03.05)

In developing the regulations on Alternative Financing with the assistance of the Office of the Board of Public Works and the Office of the Attorney General, the IAC borrowed heavily from Virginia's Public-Private Education Facilities and Infrastructure Act of 2002 (the "PPEA"), but substantially simplified the procedural requirements. The objective of the regulation was to encourage innovation in financing while ensuring compliance with State requirements on minority business enterprise participation, prevailing wages when applicable, and competitive procurement, and to ensure that any school built using alternative financing methods would meet the same building performance and educational standards as a school built through conventional financing. It was recognized that alternative financing is a fast-changing field in which new instruments are being developed by financial entities and others; thus there was a desire to encourage LEAs to explore these options, but with an eye to prudent financial management and the development of quality facilities.

The regulations outline the primary methods of alternative financing that were available at the time, but also provide that other methods can be presented if they meet the procedural requirements. The procedures involve notification to the State that the LEA intends to use the method, with a justification based on cost, schedule, and other factors; review by the IAC of the solicitation documents to ensure compliance with State procurement requirements; and review of the design documents by either MSDE or MSDE and DGS, depending on whether the State participates in the funding. The regulations require that a comprehensive agreement be developed among the parties, and that the County government concur in the use of alternative financing by the LEA.

³ In Alberta, "hard" maintenance tasks involving the routine and life-cycle maintenance of equipment and systems are carried out by the vendor; "soft" maintenance tasks like snow removal are carried out by school system personnel.

The requirement for notification to the State and State approval to proceed applies to all alternative financing projects, irrespective of funding source. However, this approval is not equivalent to approval of State funding; projects approved to proceed under alternative financing still need to be submitted for funding in an annual CIP and will be reviewed and recommended based on the same criteria as apply to conventionally financed projects.

BARBARA INGRAM SCHOOL FOR THE ARTS, HAGERSTOWN

In 2007, concurrent with approval of the regulations on alternative financing, Washington County Public Schools, the City of Hagerstown, and a local non-profit organization, the Hagerstown Neighborhood Development Partnership (HNDP), initiated a magnet high school for the performing arts in downtown Hagerstown under a public-private partnership arrangement. The motivation for this project came from an alignment between the goal of the then-Superintendent, Dr. Betty Morgan, to bring to Washington County the types of specialized high school programs that were offered in other school systems in Maryland, and the City of Hagerstown to revitalize the downtown as the arts center of western Maryland. The simple fact of locating a body of young people in the downtown, and particularly young people with an enthusiasm for the arts, has had a stimulating effect on the main downtown crossing. The magnet arts program has helped to elevate the overall expectations for public education in the community. By using the newly built public library as the school's library/media center, the nearby theater as the venue for school rehearsals and performances, and spaces in the University of Maryland extension campus for classroom instruction, the facility could be designed with a small footprint focused only on the instructional spaces needed for the visual and performing arts, while the utilization of the other public facilities was concurrently increased.

To carry out this project, the City transferred title of a three-story historic 1903 office structure to HNDP. Washington County Public Schools (WCPS) entered into a 20-year, triple-net operating lease with HNDP, with the stipulation that ownership would be transferred to the school system at the end of the lease term. The latter requirement is a condition for State funding participation in a sale-leaseback or lease-leaseback arrangement. A private consultant then competitively solicited financing for \$8.3 million to cover the bulk of the estimated construction cost. In addition, a historic tax credit was available that could be exercised if the building were under private ownership. The IAC was extremely active in the development of this unique project, reviewing the solicitations for compliance with the new regulations, ensuring that State interests such as minority business enterprise and competitive procurement were addressed, and generally trying to ensure that this unique project would not be hampered by any inadvertent violations of the new regulations.⁴

The results on bid day were favorable: in combination with the historic tax credit, the total project financing was delivered at a total cost below conventional general obligation bond financing. The proceeds of the private financing sale were placed in an escrow account under an escrow manager. HNDP then assigned the lease to the vendor but retained responsibilities as owner of the facility. HNDP and WCPS jointly engaged the constructor, with HNDP holding the contract and WCPS supervising the design and construction as agent to HNDP.

The project was completed within the established budget of \$10.93 million, which was funded from \$8.3 million of private financing, \$1.3 million from the Maryland historic tax credit that covered 20% of eligible costs of construction, and \$1.1 in legislative bond bills, a Maryland Department of Business and Economic Development (DBED) grant, and a Community Legacy grant. HNDP assigned the tax credit funds to WCPS to further retire project debt. With construction well underway, WCPS was persuaded to request funding from the State in the Public School Construction Program. Because of the time-limits on the use of State bond proceeds, the State was only able to participate in \$1.9 million of an eligible \$3.2 million.⁵ In effect, the State funding contribution will assist the school system to retire the debt somewhat earlier than anticipated.

⁴ The IAC was also active in assisting WCPS and its partners in the development of the next stage of the downtown academic complex, the HUB project adjacent to the Barbara Ingram School (described on page 5).

⁵ Interpreting Internal Revenue Service rules regarding the use of tax-exempt general obligation bonds to reimburse completed projects, the State Treasurer's Office has determined that GO bond proceeds can be used if issued

The uniqueness of the Barbara Ingram School – its location, its academic program, the constellation of stakeholders who supported the project, and the financing made possible through the historic tax credit – signified that this was not a model that could be easily reproduced under the usual conditions that apply to school projects. Nevertheless, like the Oyster School in Washington, DC, it illustrated the potential range of the public private partnership methodology.

At approximately the same time period as the Barbara Ingram School project, Harford County Public Schools and Frederick County Public Schools undertook central administration buildings using the lease-leaseback method. In both cases, central office functions that had been dispersed around the county were collected into a new, downtown office building which was financed through long-term lease payments; the avoided rental costs assisted in funding these payments. Unlike school buildings, these facilities were designed to office standards in prime locations in Bel Air and Frederick City, and were thus attractive to private sector investors in a way that is not generally true of instructional buildings.

BARRIERS TO THE USE OF ALTERNATIVE FINANCING FOR SCHOOLS

We do not know what potential alternative financing holds for Maryland's school-building task. Unlike the United Kingdom and Canada, the United States has not provided a rich set of successful projects that can be emulated, imitated, and transformed by LEAs to meet their own needs. Yonkers, New York initiated a very ambitious P3 program in the early 2000s, but the program was stopped by the city government based on problems with the cost estimates for the proposed work. Commission member Mel Franklin has indicated that a number of leaseback arrangements for schools have been undertaken in California; further research is needed to determine if these can serve as viable models for Maryland.

In the meantime, three barriers can be identified that may play a role in the lack of interest to date in using alternative financing in a broad program of school construction:

- ***Bond Proceeds.*** Because State funding for public school capital projects is provided almost entirely with the proceeds of general obligation bonds, the State participation in leaseback projects is on a lump-sum basis. In effect, the State contribution allows the local board or the local owner to write down the cost of the financing by shortening the term of the lease, reducing the amount of the lease payments, or both.

This represents a limitation in the State's ability to encourage and to participate in such projects. It would be more advantageous for both the LEA and the State if the State could participate in the lease payments over the term of the lease, but this can only be done with paygo funds. From the LEA perspective, this would provide a level of certainty about the amount and timing of State funding, which is not guaranteed under the current method for the allocation of State capital funds in the CIP. From the State perspective, it would allow a discounted allocation of funds to be invested in an interest-bearing instrument like a guaranteed investment contract (GIC), helping to use restricted State funding more effectively.

- ***Maintenance and Operations.*** The regulations require that maintenance and operations be turned over to the local board when the building becomes operational (COMAR 23.03.05.10). This requirement, which reflected concerns about the possible loss of job security among school system employees, may block the use of the design-build-finance-maintain-operate (DBFMO) method described above. The incentive for private investors to participate in a DBFMO arrangement is built partly around the stable, long-term income stream associated with an essential public facility; when the M&O component is not included, this incentive decreases.
- ***Classification of Lease Payments.*** Lease payments can be classified as for either capital or operating. Through a capital lease a user gains access to, and eventual ownership of, a capital asset. The asset may be movable or fixed, ranging from a vehicle to a building or campus. For accounting purposes a capital lease is considered to be equivalent to ownership and is treated in the same way. An operating lease provides access to the asset but does not convey any rights of ownership.

within 18 months of final payment to the contractor. For the Barbara Ingram School, because of the late date of application for funds, only three State annual payments fell within this timeframe.

Since a capital lease has the characteristics of ownership, a capital lease for a public asset may be treated as debt and count against the governmental entity's debt affordability. Apparently this occurred in Nova Scotia: the Province entered into a program to build at least 39 schools in urbanized areas under the understanding that the leases would be considered as operating leases, but provincial authorities subsequently determined that they were to be considered capital leases, adding to the Province's debt. If one of the purposes of alternative financing is to build schools outside of the regular capital improvement program funding channels, then the determination whether the lease is capital or operating is crucial to affordability.

THE CURRENT SITUATION

Interest in the use of alternative financing continues among some LEAs:

- ***Washington County Public Schools.*** Washington County has joined with the City of Hagerstown, the County Government, and the University of Maryland in an ambitious urban design project, the conversion of a parking area in the interior of a downtown block into a public plaza. Both the Barbara Ingram School for the Arts and the new academic HUB annex that is under development next to the Ingram facility back onto the future plaza, so that students will likely use this civic space and contribute their presence to its success. The high school students will also use a new university academic building on the same block for classroom work, accessing it through a conditioned corridor.

WCPS was approached by a developer to construct the HUB project. WCPS treated the offer as an unsolicited proposal and scrupulously followed the State regulation in issuing a Request for Proposal to determine if there were other approaches that might be advantageous. One other proposal was received, and WCPS determined that the original proposal was the most advantageous.

- ***Baltimore City Public Schools.*** Following passage of legislation in 2013 to renovate or replace up to 28 schools in Baltimore, there was interest in the possibility of leveraging the asset value of several under-utilized sites, providing funds for other capital projects. In April 2014 the IAC and the Maryland Stadium Authority arranged a tour of three school sites that appeared to have potential for commercial or residential purposes. However, further discussion with a developer discouraged the idea, based on the low land value of the three sites: a private entity will only be interested in entering into a public private partnership of this type if the asset has reliable value in the market (which was certainly the case for the Oyster School site, located near Connecticut Avenue and Rock Creek Park in the District). At this writing, it appears that the idea has not been pursued further.
- ***Prince George's County Public Schools.*** In 2014, Prince George's County Public Schools published a facility assessment that identified a total of \$8.5 billion in improvements to address aging structures and inadequate learning environments. New leadership in the Department of Capital Programs has recognized that if even a portion of this program is funded, it cannot be carried out using conventional financing tools and with the current and projected staff levels of the organization. The interest in alternative financing is motivated not only by the need to identify alternative methods to carry out major new school projects, but also to supplement staffing resources by transferring the responsibilities and risks of project management to a private sector agent, working under Board of Education supervision. This exploration is at an early stage of discussion with a number of private sector entities.

PROSPECTS

In order to determine if alternative financing has a valid role to play in building schools in Maryland, it will be necessary for the school systems to witness a successful example, preferably in Maryland itself. Any venture in this direction must originate from one of the LEAs, since it is the LEA that will bear the risks for financial or performance failure and will carry the burden of managing a new and relatively untried method of project delivery and finance. The most likely project set will include new vertical

construction, which carries the least construction risk of all the project types; this implies the project will be a replacement or a new facility. Since there are financial thresholds below which investors have little interest in alternative financing - \$100 million in project value is a figure that is often cited – it would also be necessary for the project to be of substantial size, or to include several projects that together would reach the cost threshold. Given the difficulties of cross-jurisdictional coordination and contracting, it is likely that the pilot project would be carried out within one of the largest jurisdictions, and one that plans to initiate a substantial number of new projects within the next three to five years.

The State could encourage innovation in this area by providing a financial incentive that would assist the LEA to cover its risks, for example by engaging a financial advisor and a construction manager with experience in projects using alternative financing, or by increasing the contingency allocation and allowing the contingency to be used for a broader set of changes than are currently allowed. Addressing the three policy barriers that are outlined above, as well as others that would likely emerge during project development, would also assist this effort.

If an LEA does undertake a pilot alternative financing project with State assistance, it would be worthwhile to fully document the process, the expectations, and the results, so that other LEAs can study the project and determine if this alternative path is one that they also wish to follow.