

# NORTH CAROLINA GENERAL ASSEMBLY



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## BLUE RIBBON COMMISSION TO STUDY THE BUILDING AND INFRASTRUCTURE NEEDS OF THE STATE (2013)

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REPORT TO THE  
2017  
GENERAL ASSEMBLY  
OF NORTH CAROLINA

DECEMBER, 2016

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## COMMISSION MEMBERSHIP

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2015-2016

**President Pro Tempore of the Senate**  
**Appointments:**

Sen. Chad Barefoot (Co-Chair)  
  
Sen. Kathy Harrington  
Sen. Ralph Hise  
Mr. Jeffrey P. Carver (Public Member)  
Mr. David T. Clancy (Public Member)  
Mr. P. Michael Juby (Public Member)  
Mr. Barry Shoemaker (Public Member)

**Speaker of the House of Representatives**  
**Appointments:**

Rep. Dean Arp (Co-Chair)  
  
Rep. David R. Lewis  
Rep. Stephen M. Ross  
Mr. Paul Davis Boney (Public Member)  
Mr. Neil T. Deans (Public Member)  
Hon. John S. Phillips (Public Member)  
Ms. Pamela B. Townsend (Public Member)

**Governor's Appointments:**

The Honorable Janet Cowell (State Treasurer)  
The Honorable Kathryn Johnston (Secretary of  
Administration)  
Mr. Charles Perusse  
Ms. Jennifer Haygood  
Mr. John David Solomon  
Mr. Andrew Heath

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# TRANSMITTAL LETTER

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December 31, 2016

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TO THE MEMBERS OF THE 2017  
GENERAL ASSEMBLY

The BLUE RIBBON COMMISSION TO STUDY THE BUILDING AND INFRASTRUCTURE NEEDS OF THE STATE (2013), respectfully submits the following report to the 2017 General Assembly.

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Sen. Chad Barefoot (Co-Chair)

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Rep. Dean Arp (Co-Chair)

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# COMMISSION PROCEEDINGS

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The Blue Ribbon Commission to Study the Building and Infrastructure Needs of the State (2013) (hereinafter "Commission") met seven times after the 2015 Regular Session. The following is a brief summary of the Commission's proceedings. Detailed minutes and information from each Commission meeting are available in the Legislative Library.

## February 22, 2016

The initial meeting of the Commission was February 22, 2016, at the Legislative Office Building. Senator Chad Barefoot, Commission Co-Chairman, presided.

Brian Matteson, Fiscal Research Division of the North Carolina General Assembly, presented an overview of public education capital funding followed by Mark Bondo, also of the Fiscal Research Division, who presented an overview of the budgeting and financing of capital projects and of Community College capital funding. Following these presentations, Commission members were given an opportunity to ask questions.

Senator Barefoot explained the Commission's scope, duties, and plans for future meetings. He then opened the floor for comments and questions. Representative Dean Arp, Commission Co-Chairman, suggested the Commission recommend extending its reporting deadline to ensure its statutory duties can be more fully completed.

## March 28, 2016

The second meeting of the Commission was on March 28, 2016, at the Legislative Office Building. Representative Dean Arp, Commission Co-Chairman, presided.

Commission member Jennifer Haygood, Executive Vice President and Chief Financial Officer of the North Carolina Community Colleges System, gave a presentation on the capital needs of the Community Colleges System. Based upon various questions posed to Ms. Haygood by Commission members, she provided the following additional information:

- \$350 million from the Connect NC Bond Act of 2015 (S.L. 2015-943) will fund capital improvement projects in the Community College System consistent with the Act's parameters.
- Community Colleges will have to match Connect NC Bond Act funds for new construction on a sliding scale using the respective county's economic tier designation.
- The \$350 million from the Connect NC Bond Act will be distributed according to the provisions set forth in the Connect NC Bond legislation.



- Each Community College develops its own master plan for capital projects.

Dr. Dennis Massey, President of Pitt Community College, gave a presentation about the college's capital needs via WebEx. Based upon various questions posed to Dr. Massey and Ms. Haygood by Commission members, the following additional information was provided:

- Athletic facilities at Pitt Community College are supported by private fundraising and most community colleges do not have intercollegiate sports. Ms. Haygood added that intercollegiate athletics cannot use State funds to support these programs.
- Prioritizing funding for capital needs across the Community Colleges System is difficult due to size disparities between campuses, increasing enrollment and, an outdated system that does not account for increased enrollment.
- Private fundraising has played a significant role in Pitt Community College capital improvement projects.
- Deferred maintenance costs are generally not accounted for when new Community College buildings come on line.

Dr. Bob Shackelford, President of Randolph Community College, spoke about that college's capital needs. In response to questions, Dr. Shackelford noted that the college's maintenance needs are greater than can be addressed without being detrimental to other areas of need. He stated that county governments must be convinced to focus more on funding existing infrastructure maintenance needs (rather than new capital projects) to ensure that buildings do not come crumbling down. To help improve the funding prioritization process, Ms. Haygood advised that the Community College System can produce a systemwide resource for use across the State, or, the State can allocate a fund to the Community College central office for distribution to campuses across the State.

William Johnson, Associate Vice President for Finance and Capital Planning for The University of North Carolina System, gave a presentation on the system's capital funding history from 2010-2016. In response to questions, Mr. Johnson indicated that the R&R funding process varies across campuses depending upon appropriations from the State. He noted that private developers generally spend about \$15 per square foot for maintenance, but the UNC System currently spends only in the \$4-5 range. Additionally, private buildings are not kept as long as the university buildings. Mr. Johnson stated that capital projects in the UNC System are based on enrollment growth and the shifting of students based on curriculum.

#### **April 18, 2016**

The third meeting of the Commission was on April 18, 2016, at the Legislative Office Building. Senator Chad Barefoot, Commission Co-Chairman, presided.

Dr. Ken Phelps, School Planning Consultant with the North Carolina Department of Public Instruction, gave a presentation on building and infrastructure needs.

Mike Taylor, Executive Director of Growth and Planning Services for Johnston County Schools, gave a presentation entitled *High Growth District Perspective and Proposed Infrastructure Needs*.

Dr. Shelton Jeffries, Superintendent of Nash-Rocky Mount Public Schools, spoke to the Commission about the infrastructure needs in his community.

After these presentations and based upon questions posed to these three presenters, the following additional information was elicited:

- Dr. Phelps stated that while lottery sales have increased, the percentage given to the public schools has decreased because in the past the funds were allocated as a percentage of revenue but are now allocated as a net amount of \$100 million. He further stated that while a return to a percentage formula would result in more revenue for schools, it would still be a minute portion of the total school construction expenditures.
- Dr. Jeffries explained that the declining enrollment in the Nash-Rocky Mount Public Schools is due to a slow real estate market, increase in charter schools, and increase in home school enrollment.
- Mr. Taylor stated that it was advantageous to have all public schools constructed to roughly the same size and same design model because it reduces cost. Dr. Phelps commented that smaller schools generally offer better educational opportunities. Senator Barefoot commented that the Commission should compare costs of similarly sized high schools across the State to see which school systems have the best practices.
- Senator Hise asked about the impact of State regulations on construction costs to which Dr. Phelps answered that the life span of buildings may impact construction costs and noted that kitchens and lunch rooms are very expensive. Senator Hise followed by asking what specific regulation the State could do away with to which Ben Matthews, Deputy Chief Financial Officer for Operations at the Department of Public Instruction, answered that there are no specific regulations issued by the State in this regard, only guidelines.
- Dr. Phelps stated that schools set aside only a small percentage of their budgets up front for maintenance.
- Senator Hise commented that the projected needs are almost two times more than local, State, and federal governments have ever budgeted for capital.
- Dr. Phelps opined that increasing funding from the State creates more equality because there are some counties that cannot afford to address their needs. He further stated the Department of Public Instruction created a computer program for counties to use to enter their needs but prioritization requests are decided by the local school boards.

Seth Robertson, State Revolving Fund Section Chief at the Department of Environmental Quality, then gave a presentation entitled *Overview of Water and Wastewater Capital Needs*. Based upon questions from Commission members, the following additional information was elicited:

- NC Connect Bond funds will go through the State reserve programs and the State Water Infrastructure Authority. Affordability indicators are being developed and the Water Infrastructure Authority wants more reliance placed on affordability criteria rather than a mere reliance on State grant funds.
- Commission member John Solomon noted that the Water Infrastructure Authority has the final say on who gets funding and has a history of spending funds well.
- Senator Hise asked Mr. Robertson what help DEQ provides local governments to prepare their applications to which Mr. Robertson replied that DEQ travels across the State to inform and train anyone interested in applying for a grant. Mr. Robertson further iterated that more could be done to ensure that local governments are better informed and prepared and to be less reactive and more proactive.

Matthew Klein, President of Utilities, Inc., and Tom Roberts of Aqua America, Inc., gave a presentation entitled *Private Sector View Points on Water Infrastructure Needs*. Part of the presentation included the privatization of water services. The services of these private companies are more expensive than those of local governments since they are a for-profit business, but they are regulated by the Utilities Commission. Water is not the only service that could be privatized. Transportation services could be privatized. Some states have privatized their utilities such as Pennsylvania, Illinois, and maybe Indiana and New Jersey. The best practices seen from these states are better asset management planning, capital planning, and sustainable technology.

Representative Arp, Commission Co-Chair, recommended that the Commission extend its required report date to make its final report to the 2017 Session of the General Assembly rather than the 2016 Regular Session. Commission Staff explained that the General Assembly will need to amend the Session Law (S.L. 2014-42) to change the reporting date. The recommendation was unanimously approved by the Commission.

[Note: S.L. 2014-42 was amended by S.L. 2016-24 to extend the reporting date]

### **August 1, 2016**

The fourth meeting of the Commission was on August 1, 2016, at the Legislative Office Building. Representative Dean Arp, Commission Co-Chair, presided.

Daniel Sater, Fiscal Research Division, gave a presentation, to review past Commission meetings and what remains to complete the Commission's work. Following the presentation the Commission then generally discussed going forward to accomplish its statutory charge.

Mark Bondo, formerly of Fiscal Research and now a Budget Analysis with the Office of State Budget Management (OSBM), gave an update on the \$200 million in Connect *Blue Ribbon Commission to Study the Building and Infrastructure Needs of the State (2013)*

NC Bonds and reported that North Carolina's current AAA bond rate is 2.08% and that it's a good time to borrow funds. These bonds are for no more than 20 years and will be used for building design and, in some cases, for construction. The OSBM, the State Treasurer, and the State Controller are preparing to issue guidance to the recipients and establishing the appropriate budget codes. Tim Romocki, Department of State Treasurer, stated that the State's AAA rating is crucial to ensuring that the interest rates stay at 2.08%.

The Commission discussed the need for State agencies to bring their needs to the Commission. Secretary Johnston stated that OSBM and the Department of Administration can present on the anticipated needs of State agencies and that Project Phoenix will be included in that presentation.

Commission Co-Chair Arp stated that the prioritization of capital needs should be addressed at the next meeting to be followed by a meeting on the funding aspect of the Commission's work. Members expressed a desire to hear from the State Water Infrastructure Authority regarding its processes.

The Commission discussed the feasibility of establishing a building and infrastructure fund to act as a dedicated source of revenue for funding capital needs for local governments, the UNC system, community colleges, and the State's capital needs until 2025. No comparable fund currently exists in North Carolina. Commission member Juby noted that Ohio has a similar fund for local governments operating like a revolving loan fund. Member Townsend expressed a desire to know how South Carolina funds capital needs.

Secretary Johnston stated that the State must keep operating costs in mind when budgeting for capital needs. The 2016 budget requires OSBM and the Department of Administration to include five years of operating costs in their capital improvement project requests. The Treasurer's office is working on school capital needs and debt capacity and exploring whether the State should make up local school board shortfalls.

The Commission discussed the role of the State vis-à-vis that of local governments. Commission Co-Chair Arp recommended that the Commission look at the counties' capacities and capital needs for education. School funding was noted to generally be a local government responsibility and that debt service impacted local government's ability to meet regular K-12 needs.

Discussion then centered on North Carolina's need to reexamine its long term approach to repair and renovation (R&R) funding including whether such funding should go into the budgets for new buildings. The distinctions between short term "operational budgeting" and long term "capital budgeting" was noted. A question was posed as to whether the methodology used by the Department of Transportation to prioritize its funding needs could be examined to determine if it could be adapted for prioritizing building R&R by other agencies and by local governments. Secretary Johnston noted that many major cities have a prioritization process in place for capital improvement projects.

The meeting concluded by discussing the remaining work of the Commission and the scheduling of future meetings.

### **October 25, 2016**

The fifth meeting of the Commission was on October 25, 2016, in the Legislative Office Building. Representative Dean Arp, Commission Co-Chair, presided.

Mark Bondo, Budget Analyst at the Office of State Budget Management, gave a presentation on *The Capital Improvement Program*.

A presentation entitled *The Cost of Moving Forward* was made by Bill Smith, P.E., with Stanford White, Inc., Chris Martin, Jr., P.E., with McKim & Creed, Roger Woods, Jr., P.E., with IBI Group, and Matt Parker, P.E., with Freudenburg IT. The presentation by these engineers analyzed the issues raised and costs incurred when maintenance, repair, and renovation of governmental buildings are neglected in favor of new construction. North Carolina has nearly 12,000 buildings worth approximately \$21 billion dollars. Annual maintenance of these assets should average about 3% of their total value which equates to a required annual maintenance budget of \$630 million dollars however, the State's maintenance expenditures on these assets only total approximately 0.5% of their value. Four solutions were suggested to alleviate the problem: (1) Reduce the inventory of buildings; (2) Spend approximately \$4.4 billion dollars to repair the buildings financed with bonds; (3) Budget for future maintenance; and (4) Improve the decision making process to ensure the long term costs are factored in.

Based upon questions from the Commission members, the following additional information was elicited:

- Leasing some real property assets rather than owning them is an option but while leasing may be cost effective for some measures, it may not be for others. Mark Bondo of OSBM indicated that whether to lease or own depends on the type of building. For example, a warehouse for storage could likely be leased but not a laboratory with high-tech equipment. Bondo also noted that OSBM looks at life cycle cost analysis for new buildings but not for current buildings. Secretary Johnston noted that the Government Finance Officers Association recommends that total life cycle costs be included in budgets.

Kim Colson, Division Director of the Division of Water Infrastructure in the Department of Environmental Quality, gave a presentation on water infrastructure. Water infrastructure is an economic development tool. The Department of Commerce has economic development tools for water infrastructure, and the Division of Water Infrastructure does not want to duplicate their efforts.

Kent Jackson, State Construction Director at the Department of Administration, gave a presentation on the Facilities Condition Assessment Program.

John LaPenta, Deputy Secretary at the Department of Administration, gave a presentation entitled *Project Phoenix Successes and Update*. Project Phoenix is the *Blue Ribbon Commission to Study the Building and Infrastructure Needs of the State (2013)*

program to more effectively manage State buildings by leveraging private investment through the sale and redevelopment of existing State buildings and properties. Its purpose is to relieve some of the budget pressure on the State's limited repair & renovation funding.

### November 14, 2016

The sixth meeting of the Commission was on November 14, 2016, at the Legislative Building. Representative Dean Arp, Commission Co-Chair, presided.

Daniel Sater, Fiscal Research Division, gave a presentation entitled *State Infrastructure Banks*. This is a self-replenishing fund used to support infrastructure development. Mississippi and Alabama have infrastructure banks. While there are differences in how these two states structure their respective banks (eg. loan qualifications, interest rates, matching fund requirements), the fundamental concept is the same. Both states make low interest loans to qualifying municipalities for capital projects using the loan interest to fund the program. Implementation of an infrastructure bank in North Carolina would require determination of:

- Eligibility criteria?
- Interest rates and match requirements?
- How to initially fund such a bank?
  - sale of buildings?
  - direct appropriation?
  - Bonds?
- How to handle defaults?
- Which agency would provide oversight and control?

Based upon questions from the Commission members, the following additional information was elicited:

- Mississippi's infrastructure bank is housed in the equivalent to North Carolina's Department of Commerce. The location of Pennsylvania's bank was unknown.
- South Carolina has a similar program for transportation projects. Mark Bondo, of OSBM, informed the Commission that the South Carolina Legislature introduced a bill to establish an infrastructure bank for public schools but the bill did not advance.
- Should North Carolina establish such a bank, whether its outstanding loans would count against the state's debt and whether it would be limited to making loans to municipalities would depend on how the bank was set up. The banks of Mississippi and Pennsylvania are limited to making loans to municipalities.

The Commission then began discussing the draft recommendations presented by the staff. Specific changes, modifications, additions and deletions were discussed. Much of the discussion centered around educational funding at the local level. Both Co-Chairman, Senator Barefoot and Representative Arp, encouraged members of the Commission to

work together to send specific recommendation requests to Commission staffer Daniel Sater.

**December 19, 2016**

The seventh meeting of the Commission was on December 19, 2016, at the Legislative Building. Representative Dean Arp, Commission Co-Chair, presided. The Commission approved the minutes from previous meetings. The Commission also reviewed and approved its final report.

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# FINDINGS AND RECOMMENDATIONS

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## **Blue Ribbon Commission to Study the Building and Infrastructure Needs of the State** **Findings and Recommendations**

### **I. Process – Findings**

The costs to purchase, lease, or renovate buildings for capital needs will vary for each project and agency. In the October 25<sup>th</sup> meeting of the Commission, the Office of State Budget and Management (OSBM) offered the examples of a textbook warehouse and a laboratory. Warehouse space is commonly available for lease when a specialized laboratory space would not be. In this instance, it may be cheaper to lease a preexisting warehouse from a private company and build a new laboratory on State owned land. The financial model used by the State should include cost of capital, lease payments, cost of construction and design of a new facility, maintenance, operating cost, and future repairs and renovations cost to a State-owned building.

“Rule of thumb” and best practice estimates are insufficient measures. The State should invest in increased training and personnel to improve data collection and analysis. The Commission heard a presentation from the Department of Administration (DOA) that the State had two traveling teams of architects and engineers who analyzed the condition of State buildings for the State’s Facility Condition Assessment Program (FCAP). Budget cuts eliminated these positions and the program was only recently reconstituted. DOA has recreated the two teams; however, that State has an additional 40 million square feet (113M Sq Ft vs 72M Sq Ft) for the teams to survey. The original program took five years for the traveling teams to assess the condition of State buildings in all counties.

**Process Recommendation 1** – Develop and utilize a uniform system for all State agencies to weigh whether it's more cost efficient for the State to lease, renovate, or construct buildings for particular agency needs and, in the case of new construction, include within such system the ability to project the total life cycle costs of building ownership.

**Process Recommendation 2** – Improve the data collection process to get a well-defined picture of the true repair and renovation needs for State owned buildings.

**Process Recommendation 3** – With respect to the State’s Facility Condition Assessment Program (FCAP), all of the following:

1. Addition of a third three-person FCAP team.
2. Additional funding for a Construction Cost Estimator to support the FCAP teams.
3. Addition of utility, repair, and other general facility operating cost data to the FCAP costing formula by implementing standard building automation software.



4. Adoption of APPA: Leadership in Educational Facilities Level 2 or similar standards as the benchmark for maintenance standards for State-owned buildings.

## **II. Funding – Findings**

Funding the repair and renovation of State owned buildings should be among the highest priorities of the General Assembly. A dedicated reserve accompanying the costs for construction would signal a commitment to maintaining the State's assets. "The Costs of Moving Forward" presentation heard by the Commission in October suggested an annual appropriation of 3% of total building value appropriated for repairs and renovations. However, only a constitutional amendment would be necessary to restrict the General Assembly in the future from raiding the fund.

Rural communities in North Carolina are more likely to face population decline and have fewer options for raising local funds than larger urban communities. The State should investigate new ways to help rural communities invest in capital improvements with a special prioritization for improvements focused on health and safety issues.

### **Funding – Recommendations**

**Funding Recommendation 4** – The General Assembly should regularly fund the repairs and renovations of current State-owned properties and create a reserve to fund the repair and renovation as well as the operations and maintenance of all new construction projects appropriated, or consider divesting the capital asset if it is not worth the investment.

**Funding Recommendation 5** – The General Assembly should incentivize regionalization of water and sewer infrastructure in small and rural communities.

**Funding Recommendation 6** – The State should recognize the hardships faced by rural communities in funding capital improvements for school districts, community colleges, and water/sewer systems.

## **III. Needs – Findings**

The Department of Public Instruction (DPI) estimates that local school boards will require \$8 billion worth of capital investment in the next five years, primarily for new schools and renovations. The Department of Environmental Quality estimates that local governments will need between \$7 billion and \$11 billion for wastewater capital needs and between \$11 billion and \$15 billion for drinking water capital needs over the next 20 years. The State and local governments must invest wisely to fund the most critical needs. Performance audits would increase the transparency of the planning process for new buildings. The public needs accurate information before voting on school bonds or the State invests funds for school construction.

Water and sewer systems are expensive to operate and maintain, especially for small or rural communities. Regionalization of the systems would allow small communities to join together to reap the benefits of scaled systems. Regionalization could include the consolidation of systems as well as the sharing of management resources, GIS data, and software. The incentives could be upfront appropriations from the General Assembly or *Blue Ribbon Commission to Study the Building and Infrastructure Needs of the State (2013)*

greater priority for grants and 0% interest loans through the State's revolving funds run by the Department of Environmental Quality.

### **Needs – Recommendations**

**Needs Recommendation 7** – Expand training programs for local government units, including school boards, to ensure capital improvement projects involving new building construction or water and sewer infrastructure improvements take into consideration the project's long and short impact on the unit's annual budget.

**Process Recommendation 8** – Require performance audits of local government units, including school boards to ensure they are utilizing existing assets and planning for future expansion in the most efficient manner and consistent with Recommendation #5.

**Process Recommendation 9** – Require submission of the performance audit to the appropriate reviewing authority as part of any unit of local government's application seeking public grants or approval of debt for either new building construction or water and sewer infrastructure improvements.

**Needs Recommendation 10** – Establish financial incentives for local governments demonstrating consistent improvement in fiscal stability through better cost-benefit analysis and long range planning when undertaking new building construction or water and sewer infrastructure improvements.