

**CAPITAL PROJECTS AND BOND
OVERSIGHT COMMITTEE**

September 19, 2000

The Capital Projects and Bond Oversight Committee met on Tuesday, September 19, 2000 at 1:00 p.m., in Room 129 of the Capitol Annex. Representative Jodie Haydon, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jodie Haydon, Chairman; Senator Robert Leeper, Vice Chairman; Senators Tom Buford and Bob Jackson; and Representatives Robert Damron, Paul Marcotte, and Jim Wayne

Guests testifying before the Committee: Secretary John McCarty, Finance and Administration Cabinet; Dr. Gary Ransdell, Western Kentucky University; Dr. Gordon Davies, Council on Postsecondary Education; Ed Hatchett, Auditor of Public Accounts; Bill Hintze, Governor's Office for Policy and Management; Jack Miller and Wayne Ritchie, University of Kentucky; Commissioner Armond Russ and Jim Abbott, Finance and Administration Cabinet; General Larry Barker, Department of Military Affairs; Warren Nash, Economic Development Cabinet; Debby Milton, Kentucky Infrastructure Authority; and Gordon Mullis, Office of Financial Management.

LRC Staff: Mary Lynn Collins, Pat Ingram, Kevin Mason, Lola Williamson Lyle, and Shawn Bowen.

Representative Damron made a motion to approve the minutes of the August 15, 2000 meeting as submitted. The motion was seconded by Representative Marcotte and passed by voice vote.

Chairman Haydon called on Ms. Mary Lynn Collins, Capital Projects and Bond Oversight Committee Staff Administrator, to review various correspondence and information items included in members' folders.

Among the items she reviewed was a staff report on various capital project developments. She said the report contained several reports on authorized, just completed, or planned capital projects at the University of Louisville (U of L): the new Delia B. Baxter Biomedical Research Building, a recently completed new housing complex for students, and a proposed plan for the Shelby Campus. She noted that the Committee's October meeting will be held at the University of Louisville, and that members would have an opportunity to learn more about these projects next month.

Representative Wayne said the plan for the Shelby Campus had created some controversy in the Louisville community and requested that U of L President John Shumaker be asked to discuss the issue at the Committee's October meeting. Chairman Haydon said that Representative Wayne's request would be relayed to Dr. Shumaker.

Chairman Haydon said next on the agenda was a follow-up discussion of an issue the Committee discussed at length at its March committee meeting: the decision by Western Kentucky University (WKU) to transfer its housing assets to the WKU Student Life Foundation. He called on WKU President, Dr. Gary Ransdell, and Finance and Administration Cabinet Secretary John McCarty to present provisions of the management agreement recently executed by WKU and the Student Life Foundation. He also noted that the President of the Council on Postsecondary Education (CPE), Dr. Gordon Davies, and the State Auditor of Public Accounts, Ed Hatchett, had also been invited to the meeting to discuss the issue.

Secretary McCarty reminded the members that last March he had agreed to work with WKU on structuring the management agreement. He said the management agreement includes three important provisions: (1) the agreement includes a provision that construction associated with the Student Life Foundation shall adhere to prevailing wage law requirements; (2) the agreement requires that all future bond issues are to be submitted to the Office of Financial Management for review and acceptance; and (3) the agreement requires that the Foundation's annual audited financial statements are to be submitted to the Finance Cabinet. Secretary McCarty said that he felt it was also important that the Committee receive the audited reports. He said he talked to Dr. Ransdell about the matter, and they agreed to do an addendum to the agreement to specify the Committee is to also receive the financial reports.

Dr. Ransdell then discussed the nearly \$40 million in capital improvements to the residence halls planned by the WKU Student Life Foundation and to be financed by a recent bond issue. In the first two years, over \$24 million will be spent to improve the residence halls. Renovation of McLean Hall, which is 52 years old, is currently underway as is construction of a new central chiller plant, which will provide, for the first time, air conditioning of six residence halls. In addition, over \$8 million in improvements, including elevator installations, are underway in three other residence halls. Next summer four residence halls will undergo complete renovation. Dr. Ransdell indicated that he was very pleased with the progress made on the residence hall improvements thus far and noted that the fire safety program for residence halls has been accelerated. He thanked both Secretary McCarty and Dr. Davies for their support and assistance in the effort.

Representative Marcotte asked what the relationship is between the Foundation and the University. Dr. Ransdell responded that the only liaison with the University is

that the Vice President of the University's Student Government Association is on the Student Life Foundation Board as a voting member. However, he said that the Student Life Foundation has no employees, and the University manages all of the Student Life Foundation properties.

Representative Damron pointed out that under the management agreement, no university or state funds are being used for the capital improvements; the bonds, issued by the Student Life Foundation through Warren County, do not count toward the state's debt cap; and repayment of the bonds will be through student fees.

In response to a question from Representative Damron, Dr. Davies said no other university has requested to take action similar to that of WKU.

Representative Damron said that he thought the transaction was a very innovative way of addressing a significant need, and that perhaps a standard has been set for other institutions of higher education.

Secretary McCarty agreed it is a very creative, innovative approach to solving some real problems. However, he cautioned that there are some unique things in this transaction and time was needed to see how the concept works. He said one \$65 or \$70 million transaction might not have a great impact from a bonding perspective, but the impact of \$300 or \$400 million should be carefully considered. He said he will probably have some additional information to share with the Committee on some of these concepts later this year or the first part of next year.

Representative Wayne said that the management agreement does not address provisions regarding state capital budget processes. He asked if sealed competitive bidding was used for the capital improvements of the residence halls now underway.

Dr. Ransdell said a bid process was followed, but he did not know if it was a sealed bid or not.

Representative Wayne asked if the Foundation's policies on procurement are identical to state policies. Dr. Ransdell said he doubted they are even though they meet the spirit of the state rules. He cited as an example the procurement for the renovation of McLean Hall. That bid came in slightly over budget and they were able to negotiate with the three lowest bidders to separate the demolition piece from the rest of the construction package to bring the project back within budget.

Representative Wayne asked Secretary McCarty how that would differ from state rules. Secretary McCarty said under state rules, the Cabinet would have had to stop the original bidding process, remove the demolition piece, and rebid the project. He said one

of things he evaluated and was comfortable with as they worked on the management agreement was the fact that there are good, solid procurement methodologies that do not necessarily comply 100 percent with state procurement laws. He said he believed that WKU and the Student Life Foundation are in a position to insure fair bid practices are utilized, which will allow projects to move much quicker than is the case under state statutes.

In response to another question by Representative Wayne, Secretary McCarty said the criteria for assuring sound procurement practices would be determined by the Foundation Board.

Representative Wayne said the Board was not accountable to the public or to the Finance Cabinet. He asked Auditor Hatchett what role his office plans to take in monitoring the Student Life Foundation.

Auditor Hatchett said that the management agreement does give his office sufficient access to the books and records of the private foundation. He said his primary concern with the concept, however, is that there is nothing in state law to require such access. He said the next similar enterprise might not include a provision allowing the State Auditor such access.

Representative Wayne expressed concern that under the provisions of the management agreement, transactions of the Student Life Foundation would not be subject to the Open Records and Open Meetings laws. He asked if there was some reason for this provision.

Dr. Ransdell said the provision was standard legal language contained in any public-private contract. He noted the Foundation is not subject to the Kentucky Open Records and Open Meetings laws, but by virtue of its affiliation with WKU, “we require that they be open, but it is not something that can be legally mandated.” He said that the student newspaper has complete access to the meetings of the Foundation, and has been present at all meetings.

Representative Wayne said if the only reason the language stating that transactions of the Foundation are not subject to the Kentucky Open Records or Open Meetings law is because it is standard language in an agreement with a private entity, why not remove the provision to assure the process is open.

Dr. Ransdell agreed to ask the Student Life Foundation to remove the provision. However, he said that the Foundation is not legally subject to such laws, and even if the provision was removed, the Student Life Foundation could not legally be made to follow the Kentucky Open Records and Open Meeting Laws.

Representative Wayne asked Dr. Ransdell to formally request that the Student Life Foundation take the provision out in an addendum to the management agreement, and to report back to the Committee in writing by the next meeting.

Chairman Haydon then asked Auditor Ed Hatchett if he had additional comments regarding the agreement. Auditor Hatchett said he thought a state law addressing these types of arrangements was needed and he identified five provisions the state law should include to protect taxpayers and better safeguard public resources: (1) the transfer of public assets to a private foundation should trigger the authority of the Auditor of Public Accounts, rather than a private CPA, to audit that foundation; (2) the scope of such audits should meet generally accepted auditing requirements; (3) annual audit reports, including management letters and other communications from CPAs, should be distributed to the Finance Cabinet, the Legislative Research Commission, the Council on Postsecondary Education, and the State Auditor; (4) the foundation's annual budgets should be distributed to the applicable University, the Finance Cabinet, and the Auditor of Public Accounts who will compare the budget of the enterprise to the actual operations; and (5) KRS 42.540 should be strengthened, by perhaps adding penalties, to assure annual filing of foundation reports with the state Office of the Controller. Auditor Hatchett noted that while KRS 42.540 currently requires private foundations operating within the Commonwealth for the benefit of a public enterprise to submit certain types of financial reports to the Controller, few of the required reports have been filed.

Auditor Hatchett also pointed out that as the issuer of the bonds on behalf of the foundation, Warren County's debt capacity was impacted by the transaction. He said that while Warren County had good reason to be involved, he suggested that planning for bonding capacity is needed at the local level as well as at the state level.

Chairman Haydon then called on Dr. Davies. Dr. Davies told the Committee he thought they would be wrestling with more things like this in the future. He said universities have to be agile and able to respond quickly. The essence of the reform effort in postsecondary education is for the institutions to be responsive to the students and the communities they serve. He pointed out that under this plan, WKU has been able to get projects started that would still be on the drawing board if it had been done in other ways.

Dr. Davies said that the Council on Postsecondary Education (CPE) asked the 2000 General Assembly for \$75 million in bonding authority for postsecondary education institutions. However, after reviewing the state's debt capacity, the Governor recommended only \$35 million in agency bond authority for postsecondary education institutions. That amount of bonding authority (\$35 million) was included in the CPE agency bond pool in the 2000-2002 enacted budget. Dr. Davies pointed out that the lower bonding authority amount puts some postsecondary education projects that have

identifiable revenue streams to pay for debt service in limbo until the 2002 Session. He urged the Committee to watch this situation.

Dr. Davies also discussed other new initiatives by universities outside of Kentucky. He said a university in Virginia has moved to set up a separate not-for-profit corporation to which it has transferred key core operations, including campus police, the administrative systems, and the registrar's office. The University of California system is building housing on its campuses for the general public in order to subsidize its faculty housing. He encouraged the Committee to look at such efforts. He said he believed Representative Damron is right in that there are many positive things about the WKU effort, but Secretary McCarty is also right that such efforts should be studied carefully.

Senator Buford asked about the reserve fund that was created by the Student Life Foundation and what would happen to it if the property reverted back to the University under the management agreement's 90-day cancellation clause.

Dr. Ransdell said that the reserve fund will provide a maintenance endowment in perpetuity that the residence halls have never had before, and he assumed that if ownership of the residence halls was transferred back to WKU, the reserve fund would also be transferred.

In response to another question by Senator Buford, Dr. Ransdell said that under the provisions of the management agreement, there is a \$40,000 annual management fee that the Student Life Foundation pays to the University.

Dr. Ransdell said that as part of the housing renovation effort, there will be new single private rooms with baths and other amenities which will be at the high end of the rental fee scale. For the other rooms, which will also be upgraded, there will be an annual 5% increase throughout the life of the associated debt service. He noted that rate conforms to historic rate increases for WKU's dormitory fees since 1972.

Senator Buford said it appears this is a winning situation for both the state and the University. He said that perhaps we do need more controls for private corporations operating for the benefit of a public enterprise, but he would recommend that any work done by the State Auditor be paid for by the state rather than the entity to be audited.

Representative Damron said in response to the Auditor's comments about Warren County's debt capacity, he felt that was a local government decision, and there are already processes in place that apply to local government debt issuance. He also said caution should be used in any deliberations relating to more control of private foundations that receive no taxpayer funds.

In response to a question from Representative Wayne, Dr. Davies said he was satisfied with the procurement procedures described by Dr. Ransdell relating to the Student Life Foundation.

Representative Wayne said he understood that several months ago, CPE directed its staff to work with Secretary McCarty to develop a procedure to review proposals similar to the WKU transfer. He asked Dr. Davies about the status of that effort and asked if such a review would include other privately-financed endeavors on university campuses such as the ones proposed at WKU relating to a clinic and a food court.

Dr. Davies said the CPE staff has not yet started that effort, but they look forward to working with Secretary McCarty on developing such procedures. He went on to say he thinks CPE's role would largely be a supportive role, and characterized CPE's interest being primarily concerned with improvement of colleges and universities whereas Secretary McCarty has a statutory concern for the management of the state's funds.

In response to a request from Representative Wayne, Dr. Davies agreed to keep the Committee informed of the CPE's efforts as those procedures are developed.

Representative Wayne said he had concerns with the discussion today relating to the blending of corporations with public institutions, and noted that all transactions of public institutions should be transparent, and if they are not, the people suffer.

Dr. Davies said he understood Representative Wayne's concerns, and that universities have to constantly be on guard against being subverted from their major purpose by private investments or partnerships. At the same time, he suggested universities need flexibility to deal creatively with the changing environment.

Dr. Ransdell said he thought he should point out that WKU did not just transfer its assets to the Student Life Foundation. The Foundation paid to the University the appraised value of \$21,565,000 for those assets.

In response to a question by Senator Leeper, Secretary McCarty said he did not know what the rating was for the bonds sold by Warren County Fiscal Court on behalf of the WKU Student Life Foundation, but he did know it was a well-received issue. He said the issue was enhanced with a letter of credit from a bank.

Senator Leeper asked if the management agreement would cover the construction of other privately financed projects that have been proposed at WKU, such as the building of a clinic or food court. Dr. Ransdell responded by saying that most universities in the state already have private contracts for food service.

Senator Leeper asked if those contracts included construction of buildings. Dr. Ransdell said that was the case sometimes. It almost always includes improvement of existing facilities. He added that several universities have contracts to run their book stores as well.

In response to the earlier question by Senator Leeper, Dr. Ransdell said the management agreement only covers the transfer of housing assets. WKU had talked about including construction of a health clinic under the current contract WKU has with Collegiate Health Care for health care services. However, he said the University has now decided not to pursue the new clinic because of a change in the scope of another project near the site where the clinic would have been built. He said that as the University negotiates a new contract with ARAMARK for food services in another year or so, they will likely negotiate with the company to build a dining facility at the company's expense on the south end of the campus where most of residence halls are located. He added that such a transaction would not use any state funds and would improve a student service.

Chairman Haydon thanked the guest participants for their comments and then called on Secretary McCarty to discuss a recent budget interpretation he had made. Secretary McCarty said the University of Kentucky received bids for several sprinkler installations that were substantially above budget. In order to allow the sprinkler projects to proceed, the University had asked Secretary McCarty to approve the transfer of agency bond authority for another project (Keeneland Hall-HVAC) to the sprinkler project. Secretary McCarty said he approved the proposed transfer of bonding authority only in the interest of public safety and that such action should not be viewed as a broad new precedent regarding capital projects.

Next Chairman Haydon called on Wayne Ritchie with the University of Kentucky (UK) Medical Center and Jack Miller with UK's Capital Construction Division to present a report on a proposed unbudgeted project, the enhancement of animal research facilities (\$1,300,000). Mr. Ritchie said the project, to be approximately 52% funded by a federal grant from the National Institute of Health, will install a purified watering system and an environmental monitoring system, and construct a quality assurance lab, an examination/treatment lab, and a post-mortem facility. The remainder of the funds for the project will be from the University's agency fund balances.

Senator Jackson made a motion to approve the unbudgeted UK project, enhancement of animal research facilities, at a scope of \$1,300,000. The motion was seconded by Senator Leeper and passed by voice vote.

Chairman Haydon then called on Mr. Bill Hintze, Deputy Budget Director, Governor's Office for Policy and management (GOPM), and Commissioner Armond

Russ, Department for Facilities Management, to discuss a project report submitted by the Finance Cabinet.

Mr. Hintze reported a scope increase of \$1,175,000 for the Western Kentucky Veterans' Cemetery, authorized in the 2000-02 budget at a scope of \$2,825,000. Mr. Hintze indicated that it has been determined that the cemetery will be located in Christian County on a larger tract than originally planned. The federal government has agreed to support 100% of the increase in scope.

Senator Buford made a motion to approve the scope increase. The motion was seconded by Representative Bob Damron, and passed by voice vote. The revised scope of the project is \$4,000,000.

Next Mr. Hintze reported on an unbudgeted project to build an administrative annex for the Kentucky Division of Emergency Management at the Boone National Guard Center in Frankfort. Mr. Hintze said this project, at a scope of \$700,000, will be 100% federally funded. Representative Wayne asked if the federal funds are a reimbursement to the General Fund. General Larry Barker, Executive Director for the Department's Office of Management and Administration, said the funding source is an administrative fee, paid to the state by the federal government, for administering federal disaster recovery programs.

Representative Wayne said in the future he wanted to see better planning on the part of the Department of Military Affairs, and asked why the federal funds were not included in the agency's budget request. Mr. Hintze said his office learned about these funds the same time the Committee did.

Representative Damron made a motion to approve the unbudgeted project for the Department of Military Affairs at a scope of \$700,000. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Hintze said the final project he had today was a report of a land acquisition by the Nature Preserves Commission, using \$380,000 in Kentucky Heritage Land Conservation (KHLIC) funds. Approximately 350 additional acres in Lewis County will be purchased as part of the Hymes Knob Project.

Chairman Haydon said no further action by the Committee on the land acquisition is required, and he introduced Mr. Warren Nash, Director of the Grant Programs in the Economic Development Cabinet's Department of Financial Incentives. Mr. Nash first discussed the annual monitoring report his agency prepares on the Economic Development Bond Pool Program.

Representative Marcotte, noting that a letter of default concerning job commitments had been sent to United Dairy Farmers and several other companies, asked Mr. Nash what would be the next step in the process for these situations. Mr. Nash said each grant contract has a specific job commitment provision as well as a penalty provision for each job not created or maintained. He said the agency is now in the process of confirming by letter how many jobs the United Dairy Farmers failed to create and/or maintain under their contract with the state, and to seek an explanation. If the staff determines the company is not going to come into compliance, they will take the matter to the Kentucky Economic Development Finance Authority Board, and seek approval to declare formally the default. At that point, efforts would be made to collect the penalty. If those efforts fail, litigation would follow.

Representative Damron asked about the status of another company, the Matsushita Appliance Corporation, which received Economic Development Bond Pool assistance for the company's plant in Danville, Kentucky. He said he understood that this company is in the process of having a massive layoff, after having made commitments to the state concerning jobs.

Mr. Nash said the company received \$500,000 in state assistance, and to this point, it has been in compliance and the job monitoring period may have expired. He agreed to provide the Committee with a report on this project at next month's meeting.

Representative Damron then asked how the money collected from penalty assessment is used. Mr. Nash said the money does not revert to the state; instead, it is made available to the local government entity to use for another economic development project approved by the Cabinet for Economic Development.

Chairman Haydon next called on Jim Abbott for a report of a lease contract. Mr. Abbott explained that the lease is for new construction in Florence, Kentucky, to be used by the Department of Community Based Services and the Service Region Administrator of the Cabinet for Families and Children. The lease is with Monohan Development Company and the annual cost will be \$187,560.

Representative Marcotte made a motion to approve the lease. The motion was seconded by Senator Jackson, and passed by voice vote.

Chairman Haydon then introduced Debby Milton, Secretary for the Kentucky Infrastructure Authority (KIA), to present two projects proposed for KIA assistance. She first discussed a proposed Fund A (Federally Assisted Wastewater Revolving Fund) loan for the City of Leitchfield, Grayson County. The Fund A loan of \$5,711,143 will be used to fund wastewater treatment plant additions and modifications. The interest rate for the 20-year loan will be 1.8%.

Senator Leeper made a motion to approve the KIA Fund A loan to Leitchfield. The motion was seconded by Representative Damron, and passed by voice vote.

The second project presented by Ms. Milton was a KIA Fund F (Federally Assisted Drinking Water Revolving Fund) loan of \$610,000 for the City of Springfield to assist in a large drinking water project (\$5,791,00) for the community. The interest rate associated with this 20-year loan will be 3.8%. Senator Buford made a motion to approve the KIA loan for Springfield. The project was seconded and passed by voice vote.

Chairman Haydon then called on Don Mullis, Executive Director of the Office of Financial Management, to present the agency's bond activity report. Mr. Mullis first discussed a proposed new bond issue, the Kentucky State Property and Buildings Commission Revenue Bonds, Project No. 68. This issue, with gross proceeds of \$162,730,000, will refund the Kentucky Asset/Liability Commission 1999 General Fund Third Series A Project Notes and provide permanent financing for projects authorized by House Bill 321 enacted by the 1998 General Assembly as well as the Capital Renewal and Maintenance Pool bond project authorized by the 2000 General Assembly for state universities.

Senator Buford made a motion to approve the new issue, State Property and Buildings Commission Revenue Bonds, Project No. 68. The motion was seconded by Senator Leeper and passed by voice vote.

Mr. Mullis said there were two school bond issues before the Committee today which include state appropriation-supported participation by the School Facilities Construction Commission (SFCC): Floyd County (\$2,000,000) and Greenup County (\$4,980,000).

Senator Buford made a motion to approve the two new school bond issues with SFCC assistance. The motion was seconded by Senator Jackson and was passed by voice vote. Representative Damron, citing a potential conflict of interest, abstained from the vote.

Chairman Haydon said there were also five locally funded school bond issues submitted to the Committee for review this month: Hancock County (\$660,000); Harrison County (\$638,000); Warren County (\$1,305,000); Whitley County (\$498,000); and Jefferson County (\$5,500,000). He said all disclosure information had been filed and no further action on these bond issues is required.

Chairman Haydon said the next meeting of the Committee is scheduled for Tuesday, October 17, 2000 at 10:00 on the campus of the University of Louisville.

With there being no further business, Representative Damron made a motion to adjourn the meeting. The motion was seconded by Senator Leeper and passed by voice vote.