

**PUBLIC HIGHER EDUCATION
CAPITAL FUNDING:
A SURVEY OF 37 STATES**

**TEXAS COUNCIL OF PUBLIC
UNIVERSITY PRESIDENTS AND
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EXECUTIVE SUMMARY

Setting priorities and securing funding for public higher education facilities, particularly classroom and research buildings which do not have a related revenue-stream, is a growing concern across the country.

Texas' public higher education institutions have filed with the Texas Higher Education Coordinating Board plans to spend over \$10 billion in capital expenditures in the next five years. Tuition revenue bonds and other revenue bonds are the major source of funds expected to pay for these capital projects (representing 48.3 percent). No identified funding source exists for \$1.6 billion of these projects, though other capital fund sources include local funds, gifts, auxiliary enterprise revenue, federal grants and the Higher Education Assistance Fund/Permanent University Fund (Texas: "A Summary of Campus Master Plans," 2004).

Texas public universities currently rely on three forms of debt:

1. Revenue bonds (pledging non-appropriated revenue to the repayment of the revenue bonds),
2. Tuition Revenue Bonds (authorized for specific purposes or projects with general revenue historically appropriated to offset a portion or all of the debt service on the bonds), and
3. Permanent University Fund and Higher Education Assistance Fund bonds (Texas: "Everything You Wanted to Know," 2005).

The Available University Fund (AUF) consists of proceeds from the Permanent University Fund (PUF), a state endowment with land grant sales and royalty income benefiting The University of Texas System, which receives two-thirds of the proceeds, and the Texas A&M University System, which receives one-third of the proceeds. The Higher Education Fund was created to benefit institutions of higher education not eligible for the AUF and is supported by general revenue fund appropriations (Texas: "Financing Higher Education," 2005). An additional source of PUF endowment revenue is investment returns.

Texas has had an informal tradition of addressing higher education facility needs every fourth year through the approval of "tuition revenue bonds" (TRB) which are issued by various university systems and institutions using their own credit capability, while the principal and interest has been provided primarily from state general revenue appropriated for that purpose.

The Permanent University Fund (PUF) and the Higher Education Assistance Fund (HEF) are recognized in statute and the State constitution, and serve as permanent capital resources, although specific capital projects are not addressed. Tuition revenue bonds depend upon new authorizations in each legislative session. As a result, various methods have been used to measure the need for TRB projects, and the procedures have changed slightly every four years.

There has also been a lack of focus on how the State should target the appropriate amount of investment to meet its higher education goals and address the State's growing population.

Each of the other 49 states could potentially provide a different strategy for addressing the capital needs of its public colleges and universities. No definitive study could be located regarding the various methods for funding capital needs for state colleges and universities. In response to proposals to change the current tuition revenue bond process in Texas, the Texas Council of Public University Presidents and Chancellors requested that its staff undertake a national study on capital funding.

An analysis of activity across the country is not a simple task, as definitions vary among the states regarding operating and capital funding. In addition, the specific allowable usage of tuition, fees, and capital funds vary from state to state. Some states define their capital budgets as only consisting of major building projects while others include major building projects, equipment, and repairs/renovations (Filipic, 2001).

The enclosed report includes responses from 37 of the 50 states. Below are the major findings from this study:

- ✦ *Most states have some sort of regular review of facilities, whether at the institution/system, coordinating board, capital-related state agency or legislature direction; the review may or may not be included in a formal master plan for higher education.*
- ✦ *Capital projects are determined after review by several entities, beginning with the individual university/system, state higher education authority/oversight agency and ultimate approval by the state's legislature/governor.*
- ✦ *In 30 states (81 percent of responding states), the legislature determines which capital projects will be implemented.*
- ✦ *An appropriations act or form of enabling legislation identifies specific projects to be debt financed in 27 states (73 percent of the survey respondents).*
- ✦ *The majority of states responding to the survey (73 percent, or 27 states) appropriate debt service for state-issued debt.*
- ✦ *Sixty-two percent of the responding states may receive state appropriations for the total construction costs of a project (23 states).*
- ✦ *Twenty-three states (62 percent) indicated that the state requires the institutions/systems to share in capital project debt at some level with 14 of these states reporting the share-requirement varies by project.*
- ✦ *Most states (87 percent, or 32 states) are not required by the state to pledge tuition revenues for capital building projects.*
- ✦ *Eight states (22 percent) reported the use of a revolving bond fund to support debt issuance for university facility projects.*
- ✦ *Twenty-nine states (78 percent) reported their universities/systems are authorized to issue debt independently.*
- ✦ *Fifteen respondents (41 percent) indicated the state does have formulas to measure the needs for classroom, research and administrative space. Of these, three states reported the state funds these types of buildings differently.*

INTRODUCTION

When the 79th Texas Legislature concluded its 2005 regular session, and two subsequent special sessions, the members adjourned without passing the proposed package of tuition revenue bond (TRB) authorizations for public higher education capital projects. In response to proposals to change the current tuition revenue bond process in Texas, the Texas Council of Public University Presidents and Chancellors requested that its staff undertake a national study on capital funding. This study, in addition to providing contextual information on the Texas processes and historical antecedents, also presents survey data provided by 37 states and integrates data, processes, and actions as reflected through an analysis of available literature regarding public higher education capital funding processes.

THE NEED FOR CAPITAL FUNDING

Stable funding is an essential element in the resources on which institutions must draw to provide a wide range of high-quality programs to students and the community. Without the predictability of funds, institutional planning and expansion are severely constrained.

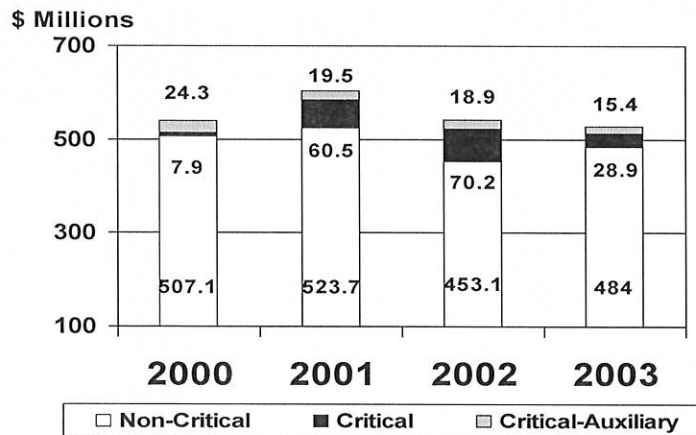
The underlying prospects for the funding base in Texas look promising and include suggestions that the Texas economy is likely to continue at a strong pace. In January 2006, the Federal Reserve Bank of Dallas released "Hot Stats" noting the Texas economy posted its best end-of-year performance since 2000.

Discussion of capital outlay funding for Texas' public universities includes new construction and proposed renovation and repair of existing facilities. The need for additional funds is clear, particularly for non-auxiliary projects¹. In fall 2004, the State's public universities presented their current capital needs to the Coordinating Board, submitting 119 applications from 47 institutions totaling \$3.73 billion, with \$3.1 billion requested to be supported by tuition revenue bonds (Texas: "Tuition Revenue Bond Authorization," 2004, p. i). The same Coordinating Board report identified 30 of the TRB applications as addressing \$167 million in deferred campus maintenance (p. iii). Auxiliary capital projects, or those capable of producing income from related fees or services (parking garages, residence halls), are funded based upon their predicted revenue stream and are included in the total project applications. Perhaps due to the ability to leverage with predicted revenues, Texas' public universities have steadily reduced critical deferred maintenance associated with auxiliary projects (Figure 1).

Much of the physical plant of Texas institutions of higher education is aging, requiring a response to issues related to safety, efficient utility-related operations, and modernization in terms of delivering high-tech services. Moreover, the physical plant requirements of some research areas with emerging technologies are extremely sophisticated, often with comprehensive health and safety needs. The need for safe and suitable space must be borne in mind as state policy makers ponder academic access, excellence, research, and efficiency.

¹ Universities seeking capital funding for auxiliary programs may be interested in forming a foundation or direct service organization to assist in debt issuance. Universities with existing foundations providing security services include the Georgia Tech Foundation, San Diego State University Foundation, San Francisco State University Foundation, University of Colorado Foundation, and the University of Minnesota Foundation (Hennigan, 2006).

Figure 1
Total Accumulated Deferred Maintenance Needs
Texas Public Universities, FY 2000-2003



Source: "Summary of Deferred Maintenance: Current Accumulated Needs, Current Expenditures, and Planned Five-Year Expenditures FY2004 – FY 2008," Texas Higher Education Coordinating Board, July 2004, p. 15. Critical refers to maintenance that places the institution's facilities, occupants, or mission at risk.

Texas higher education enrollments and facilities grew relatively slowly until the 1950s. Through the early 1970s, there was a building boom with several new campuses established and major additions made to existing campuses. Growth slowed from the mid-1970s through the early 1990s, with the legislature significantly increasing capital funding through the 1990s. As a part of the present facilities review and needs assessment process, institutions review their master plans to determine the best use of funds—to construct new buildings or maintain existing structures, with more maintenance required of the buildings constructed during the building boom of the 1970s (Texas: "A Summary of Deferred Maintenance," 2004, p. 6-7).

Texas is not alone in its time of enrollment and building growth, or in its quest for a predictable, satisfactory process and level of state support. Filipic (2001) reported on a "dearth of good data" available regarding capital funding among the states. He noted definitions vary among the states regarding operating and capital funding—while one state may define capital budget as major building projects, another may include major building projects, equipment, repairs/renovations. In his preliminary findings from a national survey with 19 states responding, Filipic reported capital support is not related to tax support for operations, noting states with demonstrated support for higher education in their operating budgets are not more likely to provide capital budget support. He also stated capital support is unrelated to demographic projections, finding that states projecting substantial growth in their high school graduating classes do not consistently spend more than states projecting little growth.

Increasing enrollment and accumulated deferred maintenance from prior building booms are not the only reasons for intense capital funding discussions. The higher education community has experienced many changes. These changes often compete against each other for facilities funding, usage and maintenance. Escalating tuition, increased square footage to operate and maintain, budget reductions, unfunded mandates, increased demand for the use of new technologies, and competing demands on institutional resources are among the many examples available (Manns, Katsinas and Medlin, 2004). Suggested actions for the higher education community presented by Manns, Katsinas and Medlin include developing a comprehensive strategic facilities planning process, providing an integrated approach to financial and facilities management, and identifying dependable funding sources.

In addition to the few individual researchers examining higher education capital funding, representatives of the National Association of State Budget Officers (NASBO) conducted capital budgeting surveys in 1997 and 1999 and, as a result, identified several trends in capital budgeting, including the linkage of capital planning decisions to statewide performance goals and strategic plans ("Capital Budgeting in the States," 1999, p. 6). The NASBO survey inquired as to the organization of capital planning processes, and reported:

The states which are most satisfied with their capital budgeting process use some way to keep their legislatures informed about the capital budget needs of the state. Some states have a formal committee made up of individuals who are in charge of financing projects, supervising construction of projects, or budgeting for the state. Committees may include both the executive branch and legislative branch members. States that have a committee in place report that it lends credibility to the capital budget process, it tends to take politics out of the decision process, and that it is perceived as a fair and equitable approach for setting capital priorities for the state. In states without a formal committee or commission to evaluate the capital budget, the budget office or the person in charge of the capital budget keeps key legislators informed... Several states have made significant changes in their capital planning processes over the last two years. These changes have emphasized a longer range outlook for capital planning, such as in Virginia and North Carolina, greater automation in the process (Alabama, Maryland, New Jersey), life-cycle cost analysis (Washington), and a link to performance measures (Colorado and Illinois). Some states, such as Illinois and Montana, have dedicated new, long-term, funding sources for capital expenditures. North Dakota has hired a state architect to oversee capital projects and Wyoming has begun to formalize the capital appropriation process (p. 15-16).

In terms of capital financing, the NASBO survey found the states regularly utilize revenue bonds and general obligation bonds, with approximately one-half of the states requiring the user of approved facilities to contribute in debt service payments. In addition to the use of bonds or cash, alternative financing arrangements often include the use of authorities, other levels of government, lease-purchase agreements, public-private partnerships, and earmarked funds (p. 37-38). Unfortunately, NASBO does not intend to update this study as a part of their current work plan (personal conversation, January 20, 2006).

HIGHER EDUCATION CAPITAL FUNDING IN TEXAS

Texas' higher education institutions plan to spend over \$10 billion in capital expenditures over the next five years. Tuition revenue bonds and other revenue bonds are the primary source of funds expected to pay for major capital expenditures planned for the next five fiscal years (see Table 1) with an additional \$1.6 billion in planned capital expenditures reported by Texas public institutions with no identified funding source (Texas: "A Summary of Campus Master Plans," 2004).