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INTERAGENCY COMMITTEE ON SCHOOL CONSTRUCTION

LILLIAN M. LOWERY, Ed.D  
 CHAIRPERSON

August 20, 2012

Ms. Sheila McDonald  
 Executive Secretary  
 Board of Public Works  
 Louis L Goldstein Treasury Building  
 Room 117  
 Annapolis, MD 21401

Re: Alternative Financing and Funding - Reporting

Dear Ms. McDonald:

The Interagency Committee on School Construction (IAC) is required to submit by September 1<sup>st</sup> of each year a report on the status of alternative financing and funding in the construction of Maryland Schools. Our annual reports in the past have provided a means not only to report on developments in this field within the preceding twelve months, but also to outline the use of these methods in other jurisdictions.

As you know, the Joint Chairmen's Report for the 2012 session of the General Assembly requires the IAC to submit by December 1 of this year a report on the use of block grant funding for Baltimore City Public Schools (JCR DE0202, page 196). The assignment involves nine separate but interrelated inquiries. In order to accomplish this task, our agency assembled a work group of experts from the State, Baltimore City Public Schools, the City of Baltimore, and the American Civil Liberties Union (ACLU), and established four subgroups to address points in the JCR that lend themselves to being grouped together:

Subgroup 1 : Needs And Capacities

*Chair : Keith Scroggins, Chief Operating Officer, Baltimore City Public Schools*

- JCR Assignment 1: Review the independent needs assessment of school buildings conducted by Jacobs Project Management for BCPSS.
- JCR Assignment 8: Evaluate the current bonding authority of the Baltimore City School System and whether the amount is adequate.

Subgroup 2 : Research

*Chair : Robin Allen, Director, Facilities Planning, Baltimore City Public Schools*

- JCR Assignment 6: Examine how other states have implemented such a block grant and the benefits and consequences of doing so.
- JCR Assignment 7: Study the creation and governance of a third party entity for school construction purposes in Baltimore City.
- JCR Assignment 9: Evaluate whether the results of this study could be applied to other jurisdictions with significant school facility needs.

Subgroup 3 : Block Grant Funding

*Chair : David Lever, Executive Director, Public School Construction Program*

- JCR Assignment 2: Evaluate the feasibility and process of providing a block grant for school construction purposes to BCPSS.

Ms. Sheila McDonald

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- JCR Assignment 3: Assess the implications of providing, or not providing, a block grant to improve Baltimore City's school facilities as expeditiously as possible, and the impact on the Public School Construction Program as a whole and on other counties.
- JCR Assignment 5: Analyze whether and how providing the block grant with proceeds from taxable and tax-exempt State debt could impact the State's bond rating, and other legal and tax implications of providing a block grant

Subgroup 4 : Management Of The Program

*Chair : Larry Flynn, Director, Facilities Design and Construction, Baltimore City Public Schools*

- JCR Assignment 4: Review best management practices for the large volume of construction projects that would likely result from such a block grant program.

The entire workgroup has met three times since mid-June; individual subcommittees have also met a number of times. At this writing, preliminary drafts of the report have been begun. We anticipate presenting a draft of the report to the IAC on November 8, 2012, with subsequent submission to the Department of General Services and then to the Department of Legislative Services prior to December 1.

In consequence of the intensive work that is now taking place to develop the report and submit it by December 1, we will not develop a separate report on alternative financing and funding by September 1, 2012. We anticipate that the Baltimore City Block Grant report will, in fact, represent the IAC's annual report, and will contain a great deal of timely information.

Please feel free to call me at any time if you have questions about this communication or the status of the Baltimore City Block Grant report.

Sincerely,



David Lever, R.A., D.A.

Executive Director

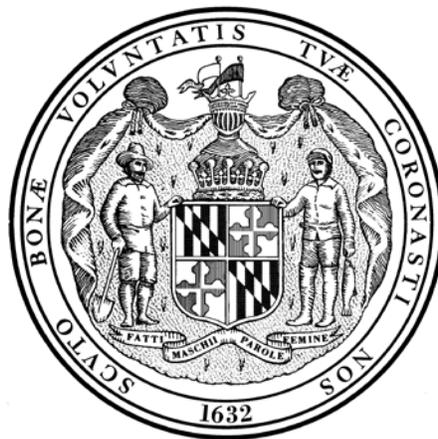
Maryland Public School Construction Program

cc: The Honorable Mike Miller, Jr., President of the Senate  
The Honorable Michael Busch, Speaker of the House  
The Honorable Edward Kasemeyer, Chair, Senate Budget and Taxation Committee  
The Honorable Norman Conway, Chair, House Appropriations Committee  
Secretary Eloise Foster, Department of Budget and Management  
Dr. Lillian M. Lowery, State Superintendent of Schools  
Mr. Richard E. Hall, Secretary, Maryland Department of Planning  
Mr. Alvin C. Collins, Secretary, Department of General Services  
Mr. Timothy F. Maloney, Member of the Public, Interagency Committee on School Construction  
Mr. Thomas S. Lewis, Member of the Public, Interagency Committee on School Construction  
Ms. Joan Schaefer, Deputy Director, Public School Construction Program

# **BALTIMORE CITY: PUBLIC SCHOOL CONSTRUCTION PROGRAM BLOCK GRANT FUNDING**

**A Report to the Legislative Committees**

**December 17, 2012**



**The Interagency Committee on School Construction:**

**Lillian M. Lowery, Chair, State Superintendent of Schools  
Alvin C. Collins, Secretary, Department of General Services  
Richard E. Hall, Secretary, Maryland Department of Planning  
Timothy F. Maloney, Member of the Public  
Thomas S. Lewis, Member of the Public  
David G. Lever, Executive Director**

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## Acknowledgments

The Interagency Committee on School Construction wishes to thank the many individuals who have contributed to the Baltimore City Block Grant workgroup and to the drafting of this report:

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Frank Patinella, Education Advocate, American Civil Liberties Union

## **Acknowledgments (continued)**

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Jason Washington, then-Senior Policy Advisor, Baltimore City Government

Josh Watters, Policy Analyst, Department of Legislative Services

## INTRODUCTION

### THE JOINT CHAIRMEN'S REPORT

In the 2012 session of the General Assembly, members of the Baltimore City delegation introduced legislation on behalf of Baltimore City Public Schools (City Schools) to require the State to provide capital funding for school construction for this local educational agency (LEA) in the form of a fixed annual block grant (Senate Bill 533 / House Bill 304). The intended purpose of the block grant was to leverage bonds issued by a third party entity in order to make available a large allocation of funds to improve school facilities in a timeframe far shorter, and on a scale far larger, than would be possible through typical annual State and City allocations.

Although this legislation was not approved, in the 2012 Joint Chairmen's Report State legislators requested the Interagency Committee on School Construction (the IAC) to conduct a study of the block grant request, the bonding capacity of City Schools, and a number of related matters concerning an alternative approach to funding public school construction. The Joint Chairmen's Report included the nine topics that are the subjects of this report. The JCR directive is as follows:

***Public School Construction Program Block Grant Funding:*** *The committees understand that there is a great need for school construction funding for Baltimore City and other jurisdictions. A number of alternatives have been put forth that enable the city to rehabilitate and construct school facilities more quickly than the current school construction funding process would allow. One such option would be to provide a block grant to the Baltimore City Public Schools which would be used in conjunction with local funds to leverage a large amount of capital funds through another entity, such as a nonprofit entity. In order to fully understand this issue and the implications of a change in the way school construction funding is appropriated, the committees request the Interagency Committee on School Construction (IAC) to study this issue, in conjunction with the State Treasurer, the Department of Budget and Management, the Baltimore City Public Schools, the Baltimore City Administration, and the Department of Legislative Services. The report should, at a minimum, (1) review the independent needs assessment of school buildings conducted by Jacobs Project Management for the Baltimore City Public Schools; (2) evaluate the feasibility and process of providing a block grant for school construction purposes to Baltimore City Public Schools; (3) assess the implications of providing, or not providing, a block grant to improve Baltimore City's school facilities as expeditiously as possible, and the impact on the Public School Construction Program as a whole and on other counties; (4) review best management practices for the large volume of construction projects that would likely result from such a block grant program; (5) analyze whether and how providing the block grant with proceeds from taxable and tax-exempt State debt could impact the State's bond rating, and other legal and tax implications of providing a block grant; (6) examine how other states have implemented such a block grant and the benefits and consequences of doing*

*so; (7) study the creation and governance of a third party entity for school construction purposes in Baltimore City; (8) evaluate the current bonding authority of the Baltimore City School System and whether the amount is adequate; and (9) evaluate whether the results of this study could be applied to other jurisdictions with significant school facility needs.*

*Report on the Fiscal 2013 State Operating Budget (SB 150) and the State Capital Budget (SB 151) and Related Recommendations by the Chairmen of the Senate Budget and Taxation Committee and House Appropriations Committee (Joint Chairmen's Report, Annapolis, Maryland 2012), page 196*

## **OVERVIEW OF THE REPORT**

This report examines the mechanics and process by which annual State block grant allocations might be developed to support a substantial issuance of tax exempt bonds by a new Baltimore City Building Authority. In this report, the IAC attempts to summarize a wide range of comments and issues concerning this concept. The proposed financing concept has been advanced by the Baltimore City Public Schools in collaboration with their bond counsel and the City of Baltimore. Extensive comments have been provided by the State Treasurer's Office, the Department of Budget and Management, and the Department of Legislative Services. Baltimore City Public Schools and its bond counsel have indicated their belief that this method to accomplish a 10-year transformation of City School facilities is feasible, is legally viable, and has precedent in other jurisdictions in the United States, and that if the Building Authority is properly constructed, the financing method is unlikely to lead to negative consequences for the State's bond rating or debt affordability calculations.

As described in Chapter I, there is a great need for school facility improvement in Baltimore City, and a well-conceived, well-managed, and accelerated school construction program would provide a clear benefit to generations of students and communities. At the same time, the IAC wishes to emphasize that this financing concept would represent a significant policy change that would require legislative action by the General Assembly. Many of the policy questions raised by the legislation are outside the role of the IAC and the scope of this report. These policy questions would include:

1. Does the General Assembly wish to create a separate mechanism for public school construction funding for one political subdivision?
2. Although the program has been referred to as a "block grant," does the degree of stable and reliable funding necessary to create marketable debt instruments really establish this as a new state formulaic program? Is the General Assembly prepared to make such a long-term commitment? Is the legislature constitutionally able to establish such a commitment, which will have some binding effect on future legislatures and administrations? The legal and policy questions related to block grant funding are addressed in Chapter II, "Structuring the Block Grant Program."

3. Is the legislature prepared to make such a commitment without a reliable forecast of this proposals' impact upon bond rating, debt affordability, and spending affordability? At several points in the report, it is indicated that the financial impacts of the proposed concept cannot be known until the Building Authority has been established and the agreements that will define the relationship of Baltimore City Public Schools, the City of Baltimore, the State, and the new Building Authority have been defined (e.g. Chapter II, page II-12ff). However, The IAC recognizes that a preliminary authorization of funds in the form of the block grant allocation may be a precondition for establishing the structure of the Building Authority and the financing method proposed by Baltimore City Public Schools.
4. What impact will this proposal have on the historic proportionality of public school construction funding among the political subdivisions, which promotes equity in school facility condition across the state (Chapter III, page III-11)?
5. If the financing proposal effectively allows Baltimore City to borrow against future public school allocations, will funding for the City then be reduced in later years?
6. Debt issuance by any building authority will not enjoy the same credit advantages as Maryland's triple-A borrowing. What will be the increased cost to taxpayers of lower grade debt and how will this impact the cost of public school construction in the City? Is this really an optimal financing method? It is recognized that, as in certain public private partnership arrangements, the higher cost of private financing may be offset by the avoidance of construction cost escalation, by reductions in operational, maintenance, and utility costs, and by efficiencies of scale that may be associated with an accelerated, concentrated construction program (Chapter III).
7. What is the market's capacity to absorb this level of school construction in such a compressed period of time, and how will that impact quality and pricing? A well-managed procurement and management process is the key to reducing the potential negative impacts of a compressed construction schedule. This issue is discussed in Chapter III, page III-13.
8. In view of the recent State audit of the Baltimore City Public Schools operating budget, what is the management capacity of the Baltimore City Public Schools to oversee this level of school construction in all of its dimensions: project quality and schedule, financial accountability, record keeping, compliance with State and City regulation and law? Chapter IV presents the Baltimore City Public Schools proposed management structure, currently under review and discussion by the IAC.
9. What will be the State's role in reviewing which schools would be selected for building authority funding and what construction guidelines would apply? Specifically, what authority will the IAC have to intervene in project planning, design, construction, and funding decisions

in a meaningful way? This issue will be a key component of the IAC's review of the proposed City Schools management plan that is presented in Chapter IV. The issue is also discussed under "Policy Concerns" (page II-9ff) and "Accountability Concerns" (page II-14ff) in Chapter II, and on pages III-14ff of Chapter III.

10. What will be the State's policy as to other subdivisions that might wish to create similar funding models, and will this obligated funding level be consistent with statewide commitments, spending affordability and debt affordability, and with the flexibility that the State may want to retain in its capital funding allocations (Chapter II, page II-12ff)?
11. The State's historical school construction commitments have fluctuated significantly from year to year depending upon economic and budget conditions and the status of other priorities in the capital budget. Is the proposed financing concept consistent with this historic fluctuation, or will it require the State to make a fixed commitment similar to the Bridge to Excellence funding?

In addition, the IAC recognizes that many aspects of the financial method and the construction program, including their potential impact on State finances as well as the operations of the IAC, will not become clear until the City Schools 10-Year Master released on November 27, 2012 and the forthcoming financial plan have been thoroughly reviewed by the IAC.

#### **SUMMARY OF FINDINGS**

1. The report provided in June 2012 by Jacobs Project Management, known as the Jacobs Report, shows that City Schools facilities are severely deficient when measured by a number of commonly accepted standards: age of facility, educational adequacy, facility condition index (FCI), and level of utilization (Chapter I, pp. I-3 to I-7). Jacobs Project Management estimates that to correct the deficiencies will require approximately \$2.45 billion in funding over a 10 year period, consisting of \$1.15 billion to correct current building deficiencies, \$.290 billion to correct certain (but not all) educational deficiencies, and \$1.01 billion to upgrade building systems pending the renovation or replacement of schools in the 10-year timeframe (Chapter I, page I-8).<sup>i</sup>
2. City Schools has developed a 10-Year Comprehensive Master Plan (the 10-Year Plan) based on the information provided in the Jacobs Report as well as input received in a series of community meetings held in the summer of 2012. The 10-Year Plan prioritizes projects for new construction, replacement, and renovation by year, and also proposes schools to be closed in order to better utilize the capacity of the school system. The 10-Year Plan was made available on November 27, 2012; City Schools indicates that a supporting financial plan will be available in January 2013. Based on a set of prioritization criteria, City Schools intends to carry out \$1.13 billion of the \$2.45 billion plan in four years; the combined State and City revenue stream required to support this initial effort is now estimated at \$66 to \$69 million per year (Introduction, page 14; Chapter VII, page VII-1).

3. The direct benefits of an accelerated construction program could include enhanced educational achievement for the current generation of Baltimore City students, reduction of the timeframe for construction of the highest priority projects from 23 years to 4 years, reduction of the cost of the program through avoidance of construction cost escalation and economies of scale, and a reduction of operating, maintenance, and utility costs for the school system (Chapter III, pages III-2 - 8). Other benefits of the 10-Year Plan could include creation of approximately 8,000 direct construction jobs through the initial \$1.13 billion of work and approximately 17,000 jobs through the full build-out at \$2.45 billion, and a contribution toward the revitalization of neighborhoods in Baltimore City (Chapter III, page III-10ff).<sup>ii</sup>
4. Since the level of funding required to improve the facilities of City Schools cannot be achieved through the current annual capital allocations of either the State or Baltimore City, an alternative approach is sought. In collaboration with the Mayor of Baltimore City, City Schools has explored alternative approaches since the fall of 2010, particularly the concept of a third party entity to issue bonds. While not widespread, the use of third party issuers to achieve a high level of construction funding has been implemented in other jurisdictions, most notably Greenville, South Carolina in the early part of the last decade. Greenville established a nonprofit corporation that issued bonds under IRS rule 63-20, commonly known as 63-20 bonds, and in addition used an installment purchase agreement (IPA) method to make the investment attractive to bond purchasers and concurrently affirm the school district's interests in the facilities. Greenville is reported to have constructed or renovated 80 schools in a six year period using these methods. While the program was undoubtedly successful in achieving numerous facility improvements that would otherwise have been either very delayed or not done at all, further research is needed to understand this program, its applicability in Maryland, and why the State of South Carolina has modified the conditions for the further use of this method (Chapter II, page II-17; Chapter VI, page VI-6).
5. In June 2012, an informal work group of experts and interested parties was established to develop the report requested by the General Assembly. The work group believes that it is both legally possible and feasible for the State to provide funding in the form of a block grant in order to leverage capital funds from a third party issuer for capital improvements within a school district in Maryland (Chapter II, pp. II-5 to II-13). The financing structure that has been proposed by City Schools in collaboration with the City envisions a Baltimore City Schools Building Authority established through State legislative action (Chapter II, pages II-1 - 4). In the view of the workgroup, the Authority as a third party entity that issues bonds, either directly or through a conduit issuer, will have sufficient distance from both the State and the City so that its debt will not be construed as debt of either government. Consequently, the workgroup believes that this structure would preserve the tax exempt status of bonds issued by the State and the City and will not impair either the bond rating or the debt affordability of either government. Certain concerns must be mentioned:
  - a. Precedent indicates that the State can have a high level of confidence that third party bond issuer financing methods can be designed to avoid a negative impact on the State (or the City)

bond rating, on its debt affordability calculations, or on the tax exempt status of its bonds. However, these impacts will only be fully known when the actual financing arrangement is presented to the rating entities and to the Internal Revenue Service (Chapter II, page II-12).

- b. Since the proposed model involves a commitment by the State to fund a single LEA with block grants at a defined level for a defined term, it may reduce the flexibility of the IAC and the Board of Public Works to respond to future project requests, particularly the need for occasional but often costly projects in small jurisdictions (Chapter III, page III-12ff).
  - c. At a current rate of at least \$250 M per year, it is already extremely difficult for the IAC to recommend adequate levels of funding to the large and mid-size jurisdictions. If State funding were to be reduced below the \$250 M level while the funding requirement for one jurisdiction were fixed by statute, a situation of funding inequity could emerge (Chapter III, page III-12).
  - d. Past experience has shown that too-rapid infusions of construction funds into the market can result in poor quality construction, contractor defaults, and a reduction of quality in the design professions. These impacts can be mitigated through careful project planning, procurement and monitoring, but a very large program in Baltimore could affect both the availability and the quality of design and construction services in the Baltimore-Washington metro region. Presumably, the market will eventually respond to a higher level of demand and will increase the flow of services, but in the short term there could be negative impacts that must be guarded against (Chapter III, page III-13).
6. Baltimore City Public Schools has worked with bond counsel and the City of Baltimore to develop a management structure for the 10-Year Plan. The success of the 10-year, \$2.4 billion school construction program will depend critically on a management structure that has adequate staffing to execute the planning, design, construction, and occupancy of multiple concurrent projects, establishes binding agreements and understandings about the rights and responsibilities of all the parties (including the IAC and the City of Baltimore), and institutionalizes mechanisms for program reporting and monitoring that ensure full transparency and accountability (Chapter IV).<sup>iii</sup>
  7. The IAC believes that a fully developed business plan is essential for the success of the 10-Year Plan. The experience of New Jersey's School Construction Corporation, discussed in Chapter II (page II-14), stands as a stark warning of the problems that can emerge in the absence of such a plan. The main elements of the business plan should consist of:
    - An educational vision and plan
    - The comprehensive facility master plan
    - The financial plan
    - The management plan

The business plan is more fully outlined in Chapter II, page II-15ff. While components of these elements are already in place or are in process, the comprehensive business plan has not been presented in its entirety at this writing.

8. The use of an installment purchase agreement (IPA) may prove to be a useful mechanism. This method for acquisition of assets is described in Chapter II, page II-17.
9. The use of block grant funding in combination with a third-party bond issuer, if successful for Baltimore City, could provide a model for other jurisdictions in Maryland that have facility needs that exceed their current funding capacity. Although there appears to be great interest in the outcome of the Baltimore City initiative, at this writing only Baltimore County has expressed interest in exploring a similar approach.<sup>iv</sup> Given a statewide facilities backlog of deficiencies that is estimated to exceed \$15 billion, an increase of funding would have obvious benefits to many students and communities. However, a caveat must be expressed: the State Treasurer's Office has indicated that an increase in State block grant funding commitments could possibly lead the rating agencies to downgrade Maryland's bond rating. The increased cost of debt would then have an effect on the total amount of funds that Maryland could borrow each year, with a consequent reduction in the amount of funds available to other LEAs. This effect cannot be predicted before the total amount of annual State funding that might be committed to block grant allocations is known (Chapter II, page II-12).

In conclusion, the workgroup members believe that the block grant funding / third party issuer structure proposed by Baltimore City Public Schools to accomplish a 10-year transformation of City School facilities can be designed in a legally sound manner, and precedent in other parts of the United States, for example Greenville, South Carolina, suggests that it can be successful for an individual jurisdiction, but *only if* at a minimum the following conditions are met:

- The City Schools business plan must be complete and thorough, touching on all aspects of the 10-Year Plan, including the educational vision, the facilities plan, the financial plan, and the management plan.
- The business plan must show that adequate staff positions to manage the program will be approved, funded, and largely filled *before* the funds are released or the third-party bonds are issued.
- The role of the IAC and the City within the City Schools program must be positively affirmed through binding agreements that will govern the responsibilities and the actions of all parties.
- The construction schedules of the specific projects identified in the 10-Year Plan should align with both the block grant allocation by the State and the issuance of bonds by the third party entity.

- City Schools must present a plan for closure of school buildings in order to better utilize its school capacity.
- In addition to the staffing that City Schools will engage to manage the program, adequate staffing must be provided to the Public School Construction Program and the three other agencies in the IAC structure in order to adequately manage the flow of project approvals, design reviews, contract approvals, change orders, minority business enterprise (MBE) issues, and project close-outs in the 10-Year Plan without impairing the services that are provided to 23 other jurisdictions and the Maryland School for the Blind.

This conclusion as to the specific financing plan proposed by Baltimore City Public Schools does not address the broad State policy questions noted at the beginning of this introduction by the IAC, which are issues that must be addressed by the General Assembly. Further review of the experience in South Carolina is recommended to determine why the program in Greenville has not been expanded or duplicated for other local jurisdictions in that state.

#### **SCOPE AND METHOD OF THE STUDY**

Recognizing the magnitude and complexity of the topics contained in the Joint Chairmen’s Report (JCR), in June 2012 the Executive Director of the Interagency Committee on School Construction established an informal working group to address the interrelated issues within the timeframe assigned. The working group consisted of representatives of a number of State agencies, of Baltimore City, of Baltimore City Public Schools, and of other interested parties, particularly the American Civil Liberties Union. A full listing of the work group participants is provided following the Table of Contents of this report. At an initial meeting on June 18, 2012, it was agreed that a sub-workgroup structure would be established to conduct the research and develop the preliminary drafts of sections of the report, to be collected, reconciled, edited, and presented by the IAC staff to the IAC for review prior to December 1. The JCR tasks were grouped by content to facilitate the development of the report. The sub-workgroups consisted of:

##### **A. Sub-workgroup 1 : Needs and Capacities**

*Chair : Keith Scroggins, Chief Operating Officer, Baltimore City Public Schools*

JCR Topic 1: Review the independent needs assessment of school buildings conducted by Jacobs Project Management for the Baltimore City Public Schools.

JCR Topic 8: Evaluate the current bonding authority of the Baltimore City School System and whether the amount is adequate.

##### **B. Sub-workgroup 2 : Research**

*Chair : Robin Allen, then-Director, Facilities Planning, Baltimore City Public Schools*

JCR Topic 6: Examine how other states have implemented such a block grant and the benefits and consequences of doing so.

JCR Topic 7: Study the creation and governance of a third party entity for school construction purposes in Baltimore City.

JCR Topic 9: Evaluate whether the results of this study could be applied to other jurisdictions with significant school facility needs.

**C. Sub-workgroup 3: Block Grant**

*Chair : David Lever, Executive Director, Public School Construction Program*

JCR Topic 2: Evaluate the feasibility and process of providing a block grant for school construction purposes to Baltimore City Public Schools.

JCR Topic 3: Assess the implications of providing, or not providing, a block grant to improve Baltimore City's school facilities as expeditiously as possible, and the impact on the Public School Construction Program as a whole and on other counties.

JCR Topic 5: Analyze whether and how providing the block grant with proceeds from taxable and tax-exempt state debt could impact the State's bond rating, and other legal and tax implications of providing a block grant

**D. Sub-workgroup 4 : Management Of The Program**

*Chair : Larry Flynn, Director, Facilities Design and Construction, Baltimore City Public Schools*

JCR Topic 4: Review best management practices for the large volume of construction projects that would likely result from such a block grant program.

Following the initial organizational meeting, the work group met again as a whole in July and August to hear reports from the subgroup chairs and to discuss a range of issues. These discussions allowed for a full interdisciplinary exposition of the complex financing, management, and technical issues that are involved in a large undertaking such as the Baltimore City Public Schools 10-Year Plan. The sub-workgroups themselves met on individual schedules that were established by their chairs. The sub-workgroups were loosely configured, so that individuals frequently participated in several sub-workgroups. The 3<sup>rd</sup> sub-workgroup, focused on the structuring of the block grant and its implications, became in effect a sub-workgroup of the whole.

With the large number of people and different organizations present during the discussions and taking part in the drafting of this report, it was inevitable that different viewpoints would emerge as to the purpose of the report, its tenor, and its specific content. The IAC has attempted to respect all of these viewpoints but to adhere closely to the expressed purpose of the General Assembly: to evaluate and

report on the nine topics raised in the Joint Chairmen’s Report, as well as on other issues that may be of importance to the Assembly’s evaluation of the block grant program:

- The report represents the thinking and concerns developed by the Interagency Committee on School Construction within the timeframe available. The IAC expresses its appreciation for the many contributions made by other groups and individuals in developing this report.
- The report attempts to be fair, balanced, impartial, and realistic. Recognizing that the 10-Year Plan is a significant and bold departure from the traditional methods used to accomplish school construction in Maryland, the IAC is highly conscious of the enormous benefits that could follow from a successful program, as well as of the risks that are involved in implementing a construction program on a scale that is unprecedented in Maryland and would be one of the largest single-jurisdiction programs in the United States.
- The IAC does not offer recommendations with respect to policy in this report, understanding that the development of policy is the purview of the General Assembly. Rather, the IAC presents the consequences of pursuing the block grant scenario that is outlined in Chapter II, and also outlines the conditions that the IAC believes must be met in order for the block grant program to be feasible and successful.
- The IAC understands that within the timeframe allowed for the development of this report, a number of issues could not be fully investigated. In particular, the following topics are noted for further research:
  - The Greenville, South Carolina funding model: benefits achieved, pitfalls avoided, lessons learned; legal applicability to the Maryland situation; and reasons for modification of the program by the State of South Carolina.
  - Use of block grants by other states: extent of the programs, accomplishments, lessons learned, future of the programs.
  - Third party entity structures that have application to Baltimore City, with a particular eye to developing thorough guarantees of accountability and transparency.
- Two advocacy groups, the American Civil Liberties Union (ACLU) and the Baltimore Educational Coalition (BEC), either contributed directly to the development of drafts or provided their recommendations. The BEC report is attached to this report as an Appendix for the consideration of the legislators.

## **THE 10-YEAR FACILITIES MASTER PLAN**

### **Purpose of the 10-Year Plan**

The key findings of the Jacobs Report are outlined in Chapter I, and clearly show that there is a very high level of need for City Schools. According to Jacobs Project Management, \$2.45 billion is required to address the total facility needs of the school system, of which \$1.44 billion is required to correct current deficiencies. Baltimore City Public Schools intends for the 10-Year Plan to provide a blueprint for how City Schools will be structured in ten years and a roadmap for facility improvements to achieve that organizational structure. City Schools states that the overall goals of the 10-Year Plan are:

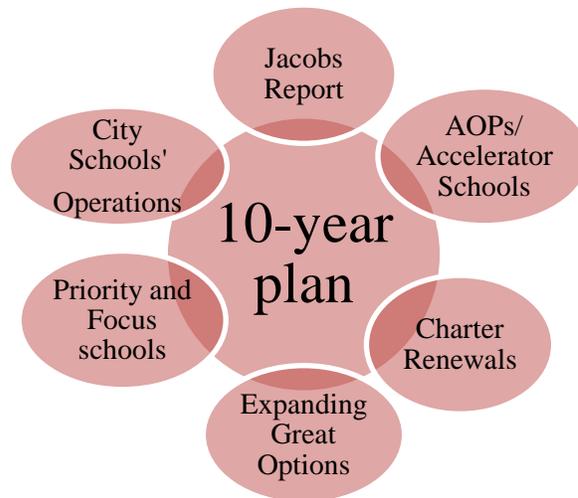
1. To right-size the building inventory to serve the current and projected enrollment, and
2. To allow every student to attend a new or totally renovated school building.

More specifically, the 10-Year Plan will allow City Schools to formulate a 10 year Comprehensive Educational Facilities Master Plan (CEFMP) for submission to the State by July 1, 2013, to guide community discussions, to prioritize individual projects, to identify facilities for closure, and to align educational programs and objectives with facilities. The IAC, which has spoken to the need for long-range planning in Baltimore City since 2003, anticipates that the 10-Year Plan will change City Schools pattern of short-term yearly planning into a stable, long-term perspective that will develop and maintain a predictable, orderly sequence of well-defined capital projects.

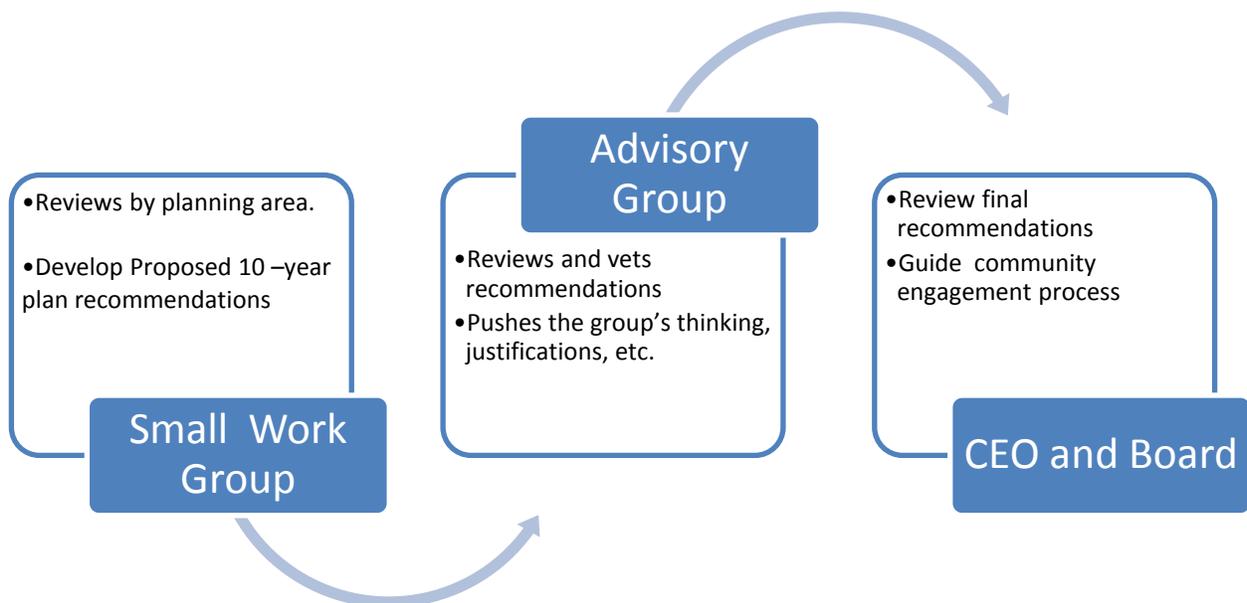
### **Overview of the Planning Process**

Following completion of the Jacobs study, a small group led by City School's Office of the Chief of Staff was assembled to begin the 10-Year Plan process; this group has been primarily focused on academic priorities for the district. The 10-Year Plan will outline the number of PreK to 8 schools, elementary schools, middle schools, transformation schools, charter schools, alternative schools, and high schools that will comprise the district's portfolio. A major factor in determining the portfolio is the current and projected enrollment at each level of City Schools.

City Schools has provided the diagram below to depict the components that will influence how the 10-Year Plan is structured. Integral to the completion of the 10-Year Plan is the prioritized set of recommendations regarding major and minor renovations or new school replacements. The opinions and recommendations from the Community Conversation forums have been included in the process for generating the initial recommendations for the 10-Year Plan.



The diagram below, also provided by City Schools, depicts the flow of decision making for the 10-Year Plan. Meetings have been convened at the small and advisory group levels in preparation for recommendations that were presented to the City Schools CEO in the fall of 2012. The recommendations approved by the CEO were released to the public on November 27, 2012 and will be presented to the Baltimore City Public Schools Board of School Commissioners for consideration on January 8, 2013. Once approved by the Board of School Commissioners, the plan will be submitted to State legislators in the winter of 2012.



## **Development of the 10-Year Plan**

### ***The Jacobs Report***

The development of the 10-Year Plan began in April of 2011 when Jacobs Project Management was commissioned to perform a complete facilities evaluation of all City Schools buildings. The evaluation covered facility condition, educational adequacy and building utilization, and was completed and publically released in June of 2012. See Chapter I, “The Condition of School Facilities in Baltimore City,” for a summary of the findings of the study. The complete report is available at the City Schools website at [www.baltimorecityschools.org](http://www.baltimorecityschools.org).

### ***Community Input***

Following the release of the Jacobs Report, 14 community meetings were held to present the Jacobs findings to the individual school communities, elected officials and community partners. School principals, teachers, parents, staff, community partners, students, citywide parent and civic organizations, and Board of School Commissioner and elected officials were asked to review the data from their respective schools. Facilitators were provided with a one-page summary, a detailed facilities condition report, a detailed educational adequacy report, and a poster board summary for their school. The facilitators, guided by the Director of Family and Community Engagement, were at each school table to assist with the process. The school community was asked to consider factors such as enrollment trends, transportation/traffic issues, community development plans, the historical significance of buildings, the condition of nearby school buildings, timing and sequencing of all school building improvements, and academic performance, all of which could affect City Schools’ facility planning. The community representatives at each table were asked to discuss the values that should guide City Schools’ 10-year Facilities Plan, and to identify the most important things participants learned from reviewing their school’s report. The facilitators recorded each school’s answers, which were preserved for inclusion in the 10-Year Plan.

### ***Formulating the Scope of Work***

The input from these meetings and other community conversations were compiled. A workgroup consisting of internal City Schools staff met during August and September to develop the initial 10-Year Plan recommendations. Data sets utilized to arrive at the initial recommendations included, but were not limited to, the following:

- Physical condition of the buildings
- Current and projected enrollment
- Special programs housed in the buildings
- Adjacent school buildings of similar grade structure
- Ability to build replacement schools on existing sites without relocating students to swing spaces
- Geographical location of student residences as related to school building locations
- Geographical and transit separations between adjacent schools

- Safe walking routes and distances for student travel to PreK-5 and PreK-8 schools in terms of high traffic roads and large intersections of high traffic roads
- Educational adequacy of the buildings
- Sociological conditions dictating neighborhood separations
- Student achievement data
- School climate data
- Reports from the City Planning department on neighborhood trends and in-progress and proposed developments
- Input from community meetings and other community conversations

***Establishing Priorities and Individual Project Scopes***

After developing recommendations for each individual building, the initial prioritization of each action was determined. Prioritization of the actions, which allowed City Schools to determine which school should receive construction work in which year of the plan, was based on the factors below and on feedback from the community meetings and conversations.

- Schools proposed for action in years 1 and 2 are schools that:
  - Will accept students from closing schools,
  - Have the most overcrowded and poorest buildings,
  - Have large amounts of excess space, or
  - Have an impact on community development
- In the middle years of the plan, a period which covers a majority of the buildings in the system, the priority order was determined by considering the cost of repairs needed now plus the ten-year life cycle costs, both as assessed by Jacobs (see Chapter I). Buildings that would cost City Schools the most in total repair-plus-life-cycle-costs would receive the highest priority.
- Schools proposed for the end of the plan are schools that have most recently received major renovations or have recently been replaced.

The “right size” issue is addressed in the 10-Year Plan by recommendations to close buildings and to consolidate adjacent schools into single new or totally renovated buildings. School rezoning is also under consideration to fine-tune any possible overcrowding in the out-years of the program.

The general scope category for each school building is set out in the 10-Year Plan. Categories include “renovation”, “renovation with possible replacement”, “renovation with addition”, “replacement building,” and other similar categories. These category designations are not final. For each proposed project, the architectural/engineering (A/E) firm assigned to the project will perform a feasibility study, including an educational specification in accordance with City Schools standards and subject to IAC review, which will determine the final scope and estimated cost of the work.

## **BACKGROUND OF THE JACOBS REPORT AND THE 10-YEAR PLAN**

### **1998: The 3D/I Study**

The Jacobs Report is not the first attempt by City Schools to assess the condition of its school buildings. In February of 1998, 3D/International (3D/I) submitted to City Schools a “Comprehensive Facilities Assessment Report.” This report provided an assessment of 176 City schools. Heating, ventilation and air conditioning systems; electrical systems; roofs; pavement; play areas and cracks in the building structures were examined. For these items, building deficiency costs for all 176 schools surveyed totaled \$424 million. In the survey, 56 schools were considered very poor and in need of immediate renovation.

However, the costs identified in the 3D/I report were only specific to correcting building deficiencies, not to carrying out complete renovations or replacements of facilities. The cost to fully renovate schools was not determined as additional fees for general construction (13%), hazardous materials and asbestos abatement (10%), and architectural and engineering design services (5%) were not considered. Also, many of the serious structural cracks that had emerged in City Schools facilities over time were not thoroughly examined in the report, nor were the costs of remediating these structural deficiencies assessed due to a stated lack of time. Most importantly, the report did not contain an assessment of educational adequacy, space utilization or enrollment projections. The absence of these educational components, which would have added 35% to the building deficiency costs, and the failure to include all structural deficiencies significantly reduced the comprehensiveness and utility of this report. Since this study was based on some but not all building deficiencies, this work did not lead to the creation of a long-term plan or a plan to correct the identified deficiencies.

Beginning in September 2003, the IAC initiated focused attention on a range of school facility issues in Baltimore City, among which the development of a 10-year comprehensive plan figured prominently. The need for such a plan was driven by multiple factors: the absence of overarching educational goals that would define the types, locations and sizes of facilities; the enormous excess of facility capacity in the school system, representing a drain on scarce maintenance, utility, and operating funds; safety issues such as lead in drinking water that could only be corrected through major capital projects; and the need to bring a stable, long-term perspective to decisions on the educational program, the enrollment, and the size of projects approved in the capital improvement program. The collaboration between the State and City Schools, including the recognition of the need for a long-term master plan, led to institutional changes in facilities management in 2005 and gave momentum to Facilities Solutions, initiated in the spring of 2006.

### **2006: Facilities Solutions**

In a second attempt to assess its school facilities, City Schools employed the services of the consulting firm DeJong, a nationally recognized K-12 facilities firm based in Dublin, Ohio. In March of 2006, DeJong submitted its draft of “Facility Solutions: The New Vision for Baltimore City Schools.” This report contained data from the assessment of 172 school buildings in the City Schools inventory. However,

unlike the 3D/International report, a team of engineers and architects was not employed to perform the assessments. Because of serious financial difficulties impacting City Schools at that time, City Schools' employees from Building Maintenance, Contract Maintenance and Capital Projects were utilized to conduct the assessments. Armed with a "School Building Systems and Component Assessment Form," City Schools employees evaluated the following 23 building systems:

Site	Exterior walls
Doors	Interior walls
Ceilings	Heating
Cooling	Domestic water
Electrical	Fire alarms
Information technology	Elevators
Playground	Windows
Roof	Corridors
Floors	Ventilation
Automatic Temperature Controls (ATC)	Plumbing
Lighting	Fire suppression
Americans with Disability Act (ADA)	

Upon the completion of the reviews, DeJong met with City Schools' staff to examine the voluminous data collected. After numerous meetings, it was concluded that 77% of City School buildings were in very poor condition and in need of major renovation. The result of this work was Facility Solutions, a plan to close 15% of City Schools' buildings, eliminate the capital project backlog, and implement preventative maintenance in all buildings. As with the 3D/International report, an educational adequacy review was not a part of the DeJong report.

Under Facility Solutions, five buildings were closed to reduce excess space and facilitate the expansion of PreK to 8 schools. However, Facility Solutions did not have a dedicated funding stream. The plan was driven by facilities and enrollment concerns rather than by academic requirements and goals; this led to a focus on space reduction through building closures and ignored the historical significance or the previous City and State investments in these facilities. PreK expansion was halted due to a lack of space for modular buildings at some elementary schools, and the addition of modular buildings at other schools actually increased the district's portfolio of space. These problems led to the abandonment of the Facility Solutions process and a shift in district priorities towards the creation of transformation high schools to serve a 6<sup>th</sup> through 12<sup>th</sup> grade enrollment, and towards the vision of creating equal educational options in all academic zones of the City.

### **2008: Expanding Great Options**

In 2008, Expanding Great Options (EGO) replaced Facility Solutions and became the academically focused effort to right-size City Schools. The EGO process was designed to provide the same academic options for students in 19 sub-areas throughout the City. In doing so, EGO dictated the closure of under-performing schools, merged under-performing schools with high performing schools, and

determined building improvements in order to support the academic programs of the schools. However, the success of EGO required the complete facility assessment of the school buildings in which academic programs were being evaluated for improvement. These assessments became an annual endeavor, which soon highlighted the fact that a complete facility assessment of all of the district-owned buildings was necessary. Through EGO, it became clear that both a financial plan and a complete facility assessment were needed in order to prioritize the work, close underutilized school buildings, and develop the 10-Year Plan.

### **2009: Vantage Point Associates Financing Study**

In November of 2009, Vantage Point Associates, Inc. submitted a report commissioned through a partnership between the City of Baltimore and City Schools. The Vantage “Innovative Financing and Procurement Alternatives Report” examined alternative methods worldwide that could be used to finance new construction or renovation of school buildings and recreation centers. Vantage Point Associates recommended an array of financial programs and options, some of which may be implemented in the City Schools 10-Year Plan.

### **ENDNOTES**

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- <sup>i</sup> Although City Schools has the oldest facilities in the State, the magnitude of the costs associated with the deficiencies is in alignment with that of other school systems in Maryland that have conducted facility assessment studies: Montgomery County \$4.5 billion, Baltimore County \$1.6 to \$1.8 billion, Prince George’s County \$2.1 billion, and Anne Arundel County \$1.7 billion. See Chapter VIII, p. VIII-5 for further discussion of facility assessment studies in Maryland.
- <sup>ii</sup> The Department of Budget and Management has calculated that every \$1 million spent in construction generates 7.2 direct construction jobs (as well as 5.1 indirect jobs in construction-related industries).
- <sup>iii</sup> The Management Plan for the 10-Year Facilities Master Plan was submitted to the IAC on November 14, 2012. The Management Plan is included in Chapter IV of this report in its entirety, as submitted and without amendment. The staff of the IAC is currently reviewing the Master Plan and, following discussion with City Schools, will submit its evaluation to the legislative committees at a future date.
- <sup>iv</sup> “Baltimore Co. Officials Eyeing City’s Creative Facilities Plan”, The Baltimore Sun, November 29, 2012.

## CHAPTER I: THE CONDITION OF SCHOOL FACILITIES IN BALTIMORE CITY

### JCR Topic 1: Review the independent needs assessment of school buildings by Jacobs Project Management for the Baltimore City Public Schools

#### OVERVIEW

The “State of School Facilities for Baltimore City Public Schools,” a report by the team of Jacobs Project Management, Dejong-Richter *et al* (the Jacobs Report, May 2012), is a district-wide assessment of the facilities of Baltimore City Public Schools (City Schools). The assessment, which was conducted from May to October of 2011, contains data regarding the overall condition and educational adequacy of school facilities as well as lifecycle forecasting data that identifies future needs with regard to buildings and their systems. The Jacobs Report concludes that City school buildings are in very poor condition as measured by the average Facilities Condition Index (FCI) of the buildings, and that the total need is for \$2.45 billion to either renovate and/or build new all of the facilities in the City Schools portfolio. The district also receives a failing grade in the capacity of its buildings to support the academic programming in the schools.

The Jacobs Report is intended to be used for long term facility planning, as it allows for the prioritizing and categorizing of needs based on industry standards of building performance as well as educational adequacy. When combined with enrollment projections, capacity data, geographical data and community input, it supports development of a 10 year plan that includes renovations, new construction, school consolidations, planning area realignments and building closures. The 10-Year Master Plan, known as the School Modernization and Renovation Transformation (SMART) program, is intended to assist in reversing the decline of academics, enrollment, graduation, test scores, and infrastructure in City Schools.

The Jacobs Report is important because it provides information to answer three important questions for City Schools:

- What data is available to verify the poor condition of City Schools’ buildings?
- When will City Schools complete its 10-Year Plan showing how the district will look in the next 10 years?
- When will City Schools right-size the capacity of the district to be compatible with current and future enrollment projections?

This chapter will summarize the key findings of the Jacobs Report. The process and purposes of the 10-Year Plan are described in the Introduction.

## **THE JACOBS REPORT**

The Jacobs Report is the third and most comprehensive assessment of City Schools conducted within the last ten years.<sup>i</sup> Unlike the Jacobs Report, neither of the two previous reviews and reports included a district-wide facilities condition assessment or a district-wide educational adequacy assessment. In addition, enrollment projections, capacity analysis and building life cycle renewal forecasting were conducted as part of this study. Summarized below are important details of the report.

Note: Throughout this report, buildings that are referred to as owned by City Schools are in fact owned by the City of Baltimore. Per a 1998 Memorandum of Understanding between the City of Baltimore and Baltimore City Public Schools, the City maintains ownership of the buildings, and when they are no longer needed by the school system for educational or other purposes they are returned to the City. City Schools will gain true ownership of any newly constructed buildings when they are complete. For simplicity they are referred to in this report as owned by City Schools.

### **A. Objectives**

The broad objectives of the Jacobs assessment were to:

- Assess educational adequacy for all instructional spaces district-wide, including charter schools not located in properties owned by City Schools;
- Assess building conditions for only those properties owned by City Schools. Charter-owned buildings and other non-City Schools buildings leased by charter schools were not assessed for building condition, as City Schools capital funding may only be used for improvements to buildings owned by City Schools;
- Identify costs to correct building condition deficiencies in district-owned facilities and correctable educational adequacy deficiencies (in the Jacobs Report, “correctable educational adequacy deficiencies” refers to deficiencies that can be corrected without major structural work or building additions);
- Provide data necessary to maintain facilities in a safe and secure manner; and
- Understand future 10-year life cycle renewal requirements for the district’s existing facility portfolio.

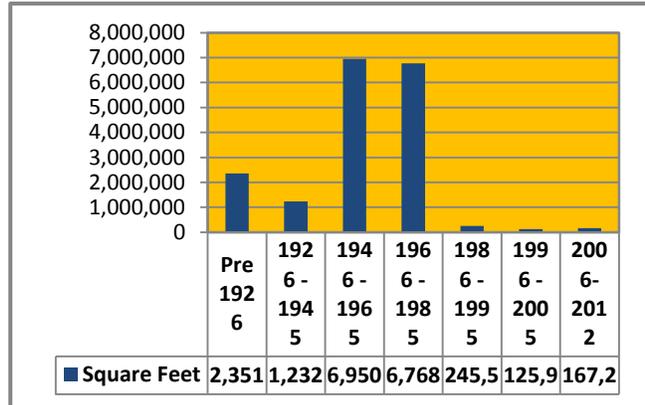
## B. Key Findings

Building Age by Age Bracket Building Average Age 33 Campus Average Age 54

### 1. Age and Size of the Inventory

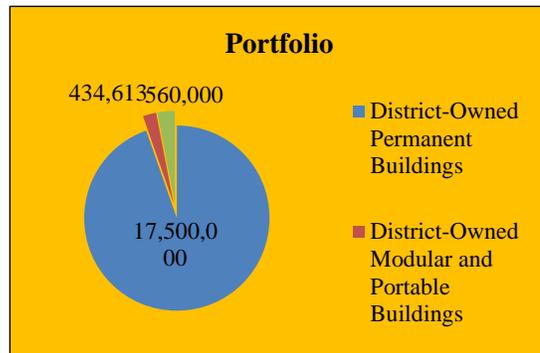
Key findings in the Jacob Report provide the following data:

- City Schools buildings are old and out of date (Jacobs Report, p. 13)
  - 23% were built prior to 1946
  - 74% were built between 1946 and 1985
  - 3% were built since 1985 – most of these are portable and modular buildings
  - The Building Average Age is 33 years (the oldest in the state).



The chart above indicates that construction of new facilities has virtually ceased over the last 25 years (although a relatively small number of buildings have undergone complete or partial renovation during this period).

- The facilities portfolio is large: 18.5 million square feet of space across 163 school campuses (Jacobs Report, p. 12; chart courtesy of City Schools)
  - 17.482 million square feet is in 183 district-owned permanent buildings
  - 434,613 square feet is in 61 district-owned modular and portable buildings
  - 561,254 square feet is in 29 buildings not owned by City Schools on 19 campuses.



**2. Condition of the Inventory**

The Jacobs Report provides an assessment of the condition of all district-owned buildings coupled with the cost of upgrading them versus the cost of replacing them, as well as the cost of maintaining the buildings over 10 years. The condition of the facility is represented by a single number, the Facilities Condition Index, or FCI. The Jacobs Report describes FCI as follows:

*The Facility Condition Index (FCI) is a widely used indicator that provides a relative scale of the overall condition of a given facility or group of facilities within a facility portfolio. The index is derived by dividing the total repair cost, including educational adequacy and site-related repairs, by the total replacement cost for the set of facilities. A campus-level FCI encompasses the site and the combination of all structures belonging to that campus. Industry standards state that FCIs over 65% represent the point where facilities should be considered for replacement. This value typically indicates the point where further expenditures on a building offer little return when compared to the potential cost of replacing that facility.*

For the Baltimore City study, Jacobs recommends a modification of the FCI criterion for replacement:

*Due to the increased total repair costs created by the incorporation of 10 years worth of life cycle component replacements over current condition costs only, it is recommended to adjust this modified FCI replacement boundary to 75%.*

*Jacobs, State of School Facilities, Baltimore City Public Schools, June 2012, page 25*

By capturing complex facility conditions in a single number, FCI provides a helpful method of conceptualizing the relative conditions of facilities as well as the overall condition of a facility inventory. FCI is represented by a percentage scale where the higher the percentage, the poorer the condition of the building and the better a candidate it may be for replacement versus repairs. Jacobs provides the following ranking scale to connect FCI with facility quality (Jacobs Report, p. 26):

The FCI scale:

- A score of less than 10%: Good
- A score of 11-30%: Average
- A score of 31-50%: Poor
- A score of 51-74%: Very Poor
- A score of 75% or greater: Replacement Candidate

**District Wide Facility Condition Index (FCI) by Campus (All Facilities)**

<10%	Repair	4	285,620
10-19%	Renovate	8	262,710
20-29%		16	1,704,089
30-39%		13	1,451,635
40-49%		16	1,747,972
50-59%		30	3,566,477
60-74%	Replace or Surplus	45	5,347,677
75-79%		7	691,467
80-89%		16	1,233,425
90-100%		16	1,527,853
>100%		11	659,282
<b>Total</b>		<b>182</b>	<b>18,478,207</b>

The above chart includes both City Schools-owned facilities and facilities not owned by City Schools. The average FCI for the district is 60%, reflecting facilities that are in very poor condition.

- 125 of the 182 school campuses – 69%, or more than two-thirds – have an FCI of 50 or higher, meaning their condition is “Very Poor” or worse.
- 50 of the 182 campuses – 28%, or more than one-quarter – have FCIs of 75 or higher and should be considered as candidates for replacement or surplus.
- 28 campuses have an FCI less than 30, indicating a condition of Average or Good.

### **3. Educational Adequacy of City Schools Facilities**

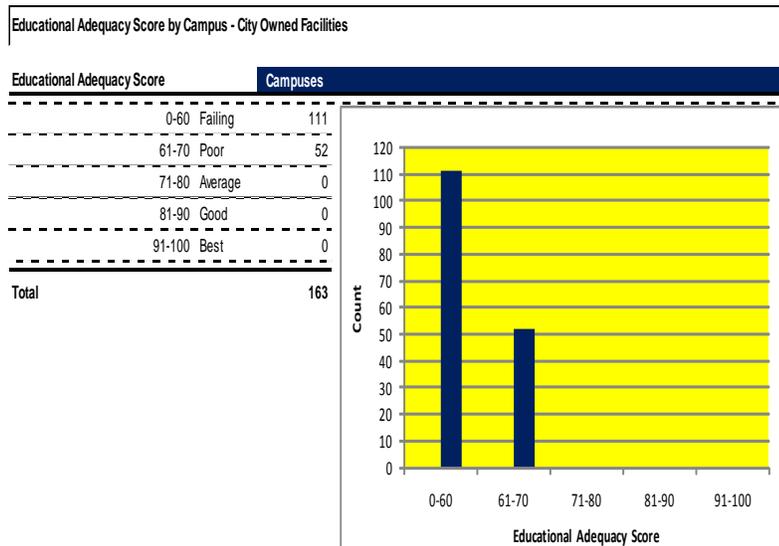
The Jacobs Report developed an Educational Adequacy Score (EAS) for all City Schools buildings by examining correctable educational deficiencies. Educational adequacy is the degree to which a school facility can adequately support the mission and methods of the programs it houses. Jacobs states:

*Correctable educational adequacy deficiencies are changes that can be made within the current layout of the building. Examples would include items such as improving storage, installing technology infrastructure, or installing science labs. These “correctable” deficiencies do not include changes to the basic structure of the building such as the size of classrooms with structural walls, the location of the cafeteria, etc.*

Jacobs, *State of School Facilities, Baltimore City Public Schools*, June 2012, page 10

- Based on the current physical condition of buildings, educational adequacy is represented by a 1-100 point scale in which higher scores reflect buildings that are better at meeting educational needs. Educational adequacy standards include:
  - Overall building security
  - Technology (cabling, electrical outlets for computers, video display screens, etc.)
  - Storage space, open space and flow of space
  - Classroom size and shape
  - Proximity of special use areas such as cafeterias and libraries to classroom lighting
  - Equipment and space to support specific curriculum offerings such as music, sports, science and technology programs
- The chart below shows that:
  - The average educational adequacy score for the district is 55 out of 100, which represents a “Failing” grade for the system as a whole.
  - Approximately 110 facilities achieved a Failing score below 60.
  - Approximately 50 facilities achieved a score between 61 and 70, ranking as “Poor” in the assessment

- A small number of school buildings have been recently renovated and presumably should achieve a score of Average or better.



Source: City Schools

#### 4. Utilization (Jacobs Report, p. 31; charts courtesy of City Schools)

City Schools ratio of square feet per student for all school types is far above the national average, indicating that many buildings are underutilized.<sup>ii</sup>

- The difference in square footage is smallest at the elementary and K-8 levels.
- The differences at the middle and high school levels are significantly higher.
- The overall utilization of City Schools is 66%, and therefore 34% of space in the district is unused, under-utilized, or used inefficiently

City Schools has an excess of available capacity in its portfolio. Consistent with the data regarding excess square footage, City Schools is significantly under-enrolled in the middle and high school levels as shown in the current and projected utilization figures. It should be noted that City Schools is currently reviewing the SRC of many of its schools in collaboration with the Maryland Department of Planning, and is concurrently identifying community use space within its school buildings, which by IAC regulation does not count toward the State Rated Capacity (COMAR 23.03.02.04.F). Both of these efforts may lead to a reduction of overall SRC and a better, and more accurate, assessment of building utilization.

City schools has much more available space per student than the national average

Type	City Schools Average Square Feet per Student	National Average Square Feet per Student
Elementary Schools	180	129
K-8 Schools	167	137
Middle Schools	408	137
High Schools	300	165
Special Education Schools	526	N/A*

With an overall capacity rate of 66%, City Schools is using just two-thirds of its available building space

School Type	2011-12 Functional Capacity	2011-12 Enrollment	2011-12 Utilization	2016-17 Projected Enrollment	2016-17 Projected Utilization
Elementary Schools	25,642	20,961	82%	23,963	93%
K-8 Schools	43,770	33,968	78%	35,565	81%
Middle Schools	7,155	3,092	43%	3,944	55%
High Schools	50,327	25,666	51%	24,327	48%
Special Education Schools	925	470	51%	569	62%

**5. Cost to Correct Identified Deficiencies**

\$2.452 billion has been identified in the Jacobs Report as the cost to bring all facilities to current standards of building performance and educational adequacy within a 10 year timeframe (without, however, necessarily addressing all of the educational needs of the school system). The figure comprises these components:

- A. Cost to correct current facility deficiencies: \$1.441 billion (Jacobs Report, pp. 21-23):<sup>iii</sup>
  - \$1.151 billion of this figure is related to the general condition of the site and buildings
  - \$290.6 million of this figure is related to correctable educational adequacy deficiencies (Jacobs Report, pp. 15-17)
- B. 10-Year Life Cycle costs: \$1.011 billion (Jacobs Report, p. 24). These are the costs of repairs that are anticipated to be required during the 10 year period during which the building deficiencies identified under A above are corrected.

Since the category of correctable educational adequacy deficiencies does not encompass all of the facility needs that are related to educational adequacy, the cost of educational corrections is likely to grow larger. Consequently, as individual projects are more clearly defined and as the total educational needs of the school system are articulated in the winter of 2012 - 2013, the total program cost could increase to account for all educational needs.

The Jacobs Report outlines a possible scenario for addressing the facility needs of City Schools (Jacobs Report, p. 33). In this scenario, the 50 schools with FCI scores of 75% or greater are replaced, resulting in a total program cost of \$2.44 billion:

- The total cost for fixing the facility condition costs, the correctable educational adequacy items, and the ten year life cycle costs will be \$2.45 billion dollars.
- If the 50 schools with an FCI score of 75% or higher are replaced or closed, there is a projected savings on the condition and life cycle costs of \$810 million.
- The cost to replace these 50 facilities (\$720 million) plus programmatic improvements (\$80 million) results in a final total cost of \$2.44 billion.

City Schools Scenario Totals	
Condition and Educational Suitability Costs	\$ 1,441,091,935
Ten Year Life Cycle Costs	\$ 1,011,137,201
<b>Subtotal:</b>	<b>\$ 2,452,229,136</b>
Repair Costs for Replacement/Surplus Candidates	\$ (810,068,535)
<b>Subtotal:</b>	<b>\$ 1,642,160,601</b>
Right Size Replacement Costs	\$ 720,000,000
Programmatic Improvements and Additions	\$ 80,000,000
<b>Total:</b>	<b>\$ 2,442,160,601</b>

## CONCLUSION

The conclusion of the Jacobs Report is that City Schools are in very poor condition. In every assessment conducted, City School did not compare favorably with other urban districts or any of the national averages. City Schools scored in the “Poor” range in the building condition assessments, the 10-year life cycle costs, the age of buildings, replacement costs, building system deficiencies, capacity, square footage per student, and enrollment in the middle and high school levels. City Schools scored in the “failing range” in the Educational Adequacy Assessment, with correctable deficiency costs of \$290 million.

## ENDNOTES

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- <sup>i</sup> For a brief history of facility assessment and planning efforts in Baltimore City between 1998 and the present, see “Background of the Jacobs Report and the 10-Year Plan” in the Introduction, page 15ff.
  - <sup>ii</sup> Abramson, Paul, “It’s Still Billions of Dollars,” *School Planning & Management, 2012 Annual School Construction Report*, February 2012
  - <sup>iii</sup> This figure includes “soft” costs: “labor and material escalation, professional fees, district administrative costs including testing, permitting, legal and advertising fees, as well as contingencies and inflation to the midpoint of construction” (Jacobs Report, page 19). Note that Jacobs includes contractor overhead and markup as a soft cost; typically these figures are accounted for as hard costs.

## CHAPTER II: STRUCTURING THE BLOCK GRANT PROGRAM

**JCR Topic 2: Evaluate the feasibility and process of providing a block grant for school construction purposes to Baltimore City Public Schools**

**JCR Topic 5: Analyze whether and how providing the block grant with proceeds from taxable and tax-exempt State debt could impact the State's bond rating, and other legal and tax implications of providing a block grant**

### OVERVIEW

Chapter I of this report has provided an overview of the condition of school facilities in Baltimore City, showing that the overall condition ranks as very poor by standards of both building performance and educational adequacy. A large-scale transformation of facilities in the City will require that a considerable amount of construction activity be accomplished within a relatively short timeframe. Since annual State and City funding levels are restricted by a number of factors, the increased funding to support this construction effort can be achieved through a leveraging approach in which the projected public funding streams are treated as long term repayments of debt issued in the form of bonds.

The work group has investigated a method by which State tax-exempt bond proceeds can be provided in a block grant format to repay tax-exempt bonds issued by a third party issuer, without adversely affecting the State's bond rating or debt affordability determinations. In this approach, the State would authorize the creation of a new Baltimore City School Building Authority (the Building Authority), which in turn could authorize a third party to issue tax-exempt bonds.

The new Building Authority will use the grant funds to pay for the construction of new and renovated schools in Baltimore City, including the financing costs related to that construction. Baltimore City Public Schools (City Schools) could carry out the design, procurement, construction, and operation of the schools, ensuring that the educational interests of Baltimore's students are well protected. The involvement of the Interagency Committee on School Construction (IAC) would be affirmed to ensure that important State interests are protected. The legislation that creates the new Baltimore City School Building Authority would be drafted to assure accountability, compliance with IAC procedures, requirements for regular reporting and independent auditing of the building program, competitive procurement, minority business enterprise participation, and use of prevailing wage rates.

This chapter describes this approach in greater detail, as well as the potential impact it will have on the State and City bond ratings and debt affordability calculations. Because JCR Topic 2 ("Evaluate the feasibility and process of providing a block grant for school construction purposes to Baltimore City Public Schools") and JCR Topic 5 ("Analyze whether and how providing the block grant with proceeds from taxable and tax-exempt State debt could impact the State's bond rating, and other legal and tax

implications of providing a block grant”) are so closely linked, they are considered together in a single chapter of the report.

## **PROPOSED FINANCING METHOD**

### **A Baltimore City School Building Authority**

Through State legislation, a new Baltimore City School Building Authority would be charged with execution of the Baltimore City 10-Year Plan. The Building Authority would either issue bonds on its own account, or authorize bonds to be issued through a third party conduit issuer. The long history of debt issuance by other authorities created under Maryland law supports the conclusion that the use of grant funds for financing costs and the issuance of debt by the new Building Authority or by a third party, for example the Maryland Health and Higher Educational Facilities Authority (MHHEFA), on behalf of the new Building Authority will not have a negative impact on the State’s bond ratings or cause the bonds of the new Building Authority or of the third party entity to be considered debt of the State.

This approach avoids a critical issue, the treatment of State bonds as refunding bonds. Because the local educational agencies (LEAs) are considered to be agents of the State under federal tax law for public school construction, if the State tax-exempt bond proceeds were disbursed in block grant form directly to City Schools to pay debt service on bonds or other obligations issued by or on behalf of City Schools, they could be considered to be “refunding” bonds of the State. Under this interpretation, City Schools as the recipient LEA would be required to follow federal tax rules on refunding issues. Although legally permissible, the “refunding” bond designation would pose complex administrative challenges for the State and City Schools, and it might impact the consideration of the debt for bond rating and debt affordability purposes, that is, it might be construed as debt of the State. Similar difficulties would follow for the Baltimore City government if the grant were made to the City rather than to the LEA; any impairment of the City Government’s bond “rating will have serious consequences on the City’s ability to fund the rest of the City agencies’ capital requests.”<sup>i</sup> The use of the Building Authority rather than City Schools or the City as recipient of the State grant would thus allow the State to fund the block grants with tax-exempt bond proceeds without adversely affecting the tax exemption of the State’s bond issuance.

The legislation that would create the new Building Authority would grant it powers to acquire, construct, design, improve, and renovate school facilities in Baltimore City. However, much of the work of the new authority would be accomplished by City Schools. The formal relationship between the Building Authority and City Schools would be defined in such a way as to ensure that the Authority preserves ultimate decision-making powers.

This approach presents certain advantages:

- There is precedent in the State for the creation of authorities that receive State funding through grants and other funding made from State bond proceeds. Examples include the East Baltimore

Development Corporation, the Technical Education Development Corporation, and the Maryland Agricultural and Resource Based Industry Development Corporation (MARBIDCO). The Maryland Health and Higher Educational Facilities Authority is well respected in the market place as an issuer of conduit debt.

- The arrangement allows the use of State tax-exempt or taxable bond proceeds to fund the grants without impacting State debt capacity or bond ratings, because the new Building Authority would not be a related party to the State under the federal tax laws. The debt of the new Building Authority or of an entity such as the Maryland Health and Higher Educational Facilities Authority would not be considered State debt or affect the rating of the State bonds.
- State requirements on competitive procurement of construction, minority business enterprise requirements, prevailing wage rates, and high performance schools, as well as the IAC's review of projects, awards of contracts, and other duties, can be incorporated into a memorandum of understanding and into contracts with the City Schools (if it is determined that City Schools will actually design, contract, and operate the schools under the Building Authority).
- The accountability and reporting requirements, independent auditing, and record keeping of the new Building Authority will be conducted under appropriate procedures that are defined by all of the stakeholders.
- The approach removes any concern about the comingling of funds or the pledge of operating funds of the State, City, or Baltimore City Public Schools.

Certain concerns must also be addressed in order to implement the financing method:

- The contractual relationships implied by this structure, in particular the memorandum of understanding that will govern the relationship of the IAC to the Building Authority and City Schools and the relationship of the City to these entities, should be addressed in advance of authorization of the block grant funds.
- The myriad administrative issues that are addressed under Accountability in this chapter and in Chapter IV, Management of the Program, including the development of a thorough business plan and the engagement of adequate staff by all of the parties that are involved, should also be addressed in advance.
- It must be understood that during the long life of the 10-Year Plan and the subsequent repayment of third party bond issuances, the cost of borrowing money is bound to change. This will affect the final "cost" of the construction program and the ultimate cost to the State and the City, since both governments will be issuing bonds to cover the debt for a long period of years.

### **Other Alternative Financing Methods**

Two other methods of financing that were discussed by the work group were set aside as not feasible because of the administrative complexities they would entail and the potential impact they could have on the City and State bond ratings and debt affordability. These methods are described at length in the Endnotes.<sup>ii</sup>

### **Common Features of All Alternative Financing Methods**

The following apply to all methods of alternative financing in which State and City tax-exempt bond proceeds are allocated as grants to pay for construction costs funded through third party obligations:

1. Collateral in the form of a leasehold security interest in the construction projects could be used to improve the marketability of the third-party bonds.
2. Holders of the third-party bonds would be made aware that annual disbursement of State and City funds are subject to appropriation, and the third-party bonds would contain language that clearly states that the debt is not State debt or City debt and is payable only from the identified sources.
3. Until a specific bond issuer is selected and negotiations take place, it will not be possible to say exactly what the terms of the arrangements will be.
4. The City could provide its portion of the annual grant funding through a combination of debt and other sources, e.g. the beverage tax.
5. *Accountability*: The legislation creating the new Building Authority will require compliance with the IAC processes for project approval, design review, contract approval, change orders, and project close-out, with appropriate modifications approved by the IAC.
6. *Record keeping*: Protocols for record keeping and reporting will be established in a memorandum of understanding to enable the IAC to track the State-financed improvements in the schools. This is a necessity for accurate assessment of future capital improvement program (CIP) requests for these same buildings, as well as for maintaining a statewide inventory of the condition of all school buildings. The City government would also need to be provided with adequate records of the use of its funding, ideally by a similar memorandum of understanding.
7. *Longevity*: There needs to be clarity about the life of the block grant program. The term of the block grant should be for a minimum term equal to the term of the outstanding bonds to provide potential bond holders with assurance and proper stability. Options include 1) The block grants will be coincident with the life of the bonds and 2) The block grants will be for a specified time frame, e.g. 40 years.

8. *Installment purchase agreement*: The use of an installment purchase agreement (IPA) may prove to be a useful mechanism to preserve the tax-exempt nature of the third-party bonds. The IPA concept is described on page 18 of this chapter.

## **FEASIBILITY, IMPLICATIONS, AND PROCESS OF BLOCK GRANT FUNDING: GENERAL CONSIDERATIONS**

The feasibility and impact of providing a block grant to City Schools for school construction purposes rests on the three broad areas outlined below and discussed in further detail in this chapter. No discussion of the feasibility of a financing mechanism can exclude the impact it will have on the City of Baltimore, since the agreement of the City in any proposed funding is essential. The City plays and will continue to play an essential role in assisting Baltimore City Public Schools to carry out its educational mission. However the City, like the State, must ensure the continuity of all public services to its citizens beyond education. Therefore, the majority of the issues examined below will consider the impact of the block grant approach on both the State and the City.

### **1. Legal Concerns:**

- A. The legal authority of the State and the City of Baltimore to make capital contributions to public school construction in the form of block grants.
- B. The use of block grants to pay debt service on long-term obligations issued by another entity.

### **2. Policy Concerns:**

- A. The current policies of the State and the City indicating that bond proceeds are to pay for individually identified and approved school projects.
- B. The current policies of the State and the City indicating that bond proceeds are to pay for capital assets rather than for operating expenses, such as the debt service of a third-party issuer.
- C. The current policies of the State and the City to manage general obligation debt and all forms of State obligations in order to maintain the State's AAA bond rating and the City's AA bond rating.

### **3. Accountability Concerns:**

- A. Assurance that schools in Baltimore City that are built through a block grant program will be equivalent in capacity and quality to those built through traditional funding and financing mechanisms.

- B. Assurance that State and City funds in the form of block grants will be used efficiently, effectively and only for the purposes for which they are granted.
- C. Assurance that State interests in competitive procurement, minority business enterprise participation, the use of prevailing wage rates, and high performance school buildings will be preserved and protected.

## 1. LEGAL CONCERNS

<b><i>A. The legal authority of the State and the City of Baltimore to make capital contributions to public school construction in the form of block grants.</i></b>
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### **Legal Authority**

The Office of the Attorney General has determined that there is no barrier in State law to making capital funds available to local educational authorities (LEAs) in the form of block grants. In an Advice of Counsel dated March 24, 2011, addressed to counsel for Baltimore City Public Schools and to Baltimore City, the Deputy Counsel to the Maryland State Department of Education “did not find any statute prohibiting block grant distribution of State school construction funds” (Conclusion, page 3; see Appendix 1). However, the Deputy Counsel did note that “significant legal, policy, and administrative issues present road blocks to such distribution”. It is important to note that these same legal, policy and administrative issues, including putting the issue in some form before the voters of the City of Baltimore, would exist if the City were to make capital funds available to City Schools in the form of block grant allocations.

The work group is aware of the complexity of the process that is under consideration, but believes that the creation of a Baltimore City School Building Authority under State law will allow the establishment of a legal structure that can address the legal, policy, and administrative issues alluded to in the Advice of Counsel. Many of these issues are addressed under the Accountability section of this chapter below, as well as in the Chapter IV section on the management of the program.

### **Taxable Bonds**

The legal issues alluded to above relate primarily to federal tax law and regulations and the use of State tax-exempt bond proceeds to fund block grants for public school construction. The use of taxable bond proceeds by the State to fund block grants for public school construction would avoid these legal issues, but it would likely also result in greater interest costs to the State.

### **Tax-Exempt Bonds**

#### ***Related Party Status***

For federal tax law purposes, LEAs are considered to be agents of the State for public school construction; they are considered to be “related” entities. This is the current and consistent advice of

the Office of the Attorney General, supported by research and advice of bond counsel and by numerous decisions of Maryland courts. A comprehensive review of the legal authority behind this position is found in the endnotes.<sup>iii</sup>

As noted above, whether or not tax-exempt bonds are considered “refunding” bonds subject to federal tax rules on arbitrage and rebate depends in part on the timing of the spending of the proceeds. The federal rules include tracking and accounting for all investments, earnings and expenditures of the block grant for purposes of reporting by the State or another governmental entity issuer -. Under federal tax law, tax-exempt bond proceeds disbursed as a block grant by a public governmental body to an LEA or other “related” entity would not be considered to be expended by that body until they are paid by the LEA to a third party, e.g., a contractor. As a result, if the LEA is the block grant recipient, this would result in an additional administrative burden for both the public body and the LEA receiving the block grant.

The disbursement of State tax-exempt bond proceeds to an LEA for project-specific school construction costs previously paid by the LEA are considered to be “reimbursements” and not “grants” for federal tax purposes, and must follow federal tax rules on reimbursements. Under current practice, tax-exempt bond proceeds are used to reimburse LEA construction expenses as they are incurred. Because of the short time frame for reimbursement of these expenses, the tax-exempt bond proceeds used for payment are not required to be treated as grants, which allows the State to comply with applicable tax rules and to avoid the administrative consequences associated with making grants. The State’s Public School Construction Program (PSCP) pays for project costs through two methods: 1) direct payment to the contractor, and 2) reimbursement to an LEA for compensation previously made to the contractor. While Maryland law allows allocations to precede contract award by up to two years, reimbursements are typically made within a maximum of 14 days from the date that the Public School Construction Program (PSCP) receives the request from the LEA. While the time between payment to the contractor and submission of the request for reimbursement varies from district to district, it is thought to be not more than about two months. The timeframe is never more than 18 months, and this occurs only in cases where an LEA has paid the contractor before receiving an allocation from the State in an annual CIP.<sup>iv</sup>

#### ***Non-Related Party Status***

If the State were to make block grant reimbursements directly to an LEA over a long timeframe, the arrangement could impair the State’s compliance with tax law requirements, potentially jeopardizing the tax-exempt status of the bonds. However, these negative tax consequences are avoided if the bond proceeds are granted to an entity that is not related to the State, such as the Building Authority described above.

***B. The use of block grants to pay debt service on long-term obligations issued by another entity.***

The implication of using State bond proceeds in a block grant to pay for the long-term obligations of a third party depends on whether the State bonds are considered to be taxable or tax-exempt.

**Taxable Bonds**

As noted above, there is no legal impediment to using the proceeds of State taxable bonds, disbursed in the form of a block grant to an LEA, to pay debt service on bonds or other obligations issued by another entity. However, the interest rates on taxable bonds historically have been greater than the interest rates on tax-exempt bonds, and over time this differential could result in significantly higher interest costs to the State. Although there is a historical differential between interest rates on taxable and tax-exempt bonds, the differential may vary greatly at any given point of time based on market conditions and makes any calculation of the increased interest cost of taxable debt unreliable. While current interest rates show that the disparity in cost between taxable bonds and tax exempt bonds is not significant, this situation could change rapidly with the recovery of the national and regional economy, exposing the State to considerable risk at some future date. Because of this risk factor and the historically wide spread between interest rates on taxable and tax-exempt debt, this option was not further explored by the work group.

**Tax-Exempt Bonds: Prior Use of Block Grants**

Although there is no legal barrier to State allocations in the form of a block grant, it appears that State funds for school construction were never previously issued in this form. Since the founding of the Public School Construction Program in 1971, projects have been requested and funded on an individual basis, so that the total annual allocation for each LEA is simply the sum of funds allocated to all of the approved projects. This approach, which apparently has never been questioned outside of an occasional legislative bill (e.g. SB 626, 2011 Session), has served Maryland well in several respects:

- State bond proceeds are always tied directly to a specific capital improvement; thus the potential withholding of State funds serves as a way to ensure compliance with State law and regulation.
- A high level of assurance is provided before funds are allocated that the project is eligible for State funding, and that State funds will be used only for eligible items within the project.
- The danger of over-allocating State funds to an LEA is reduced, since the annual allocation is tailored to the actual request, which presumably reflects local need and local capacity to provide matching funds, as well as the actual expenditure requirements of the specific project.
- The State method of allocation corresponds to the method that the Maryland counties use to establish their local capital improvement programs, leading to a consistent method of tracking project expenditures and completion.

Since in a block grant arrangement the State funds would be allocated in advance of project approval and based on a statutorily defined amount, some of the accountability features of a project-based allocation procedure have the potential to be lost. These accountability features can, however, be instituted through the statute that establishes the Building Authority and under a memorandum of understanding between City Schools and the IAC, and possibly between City Schools and the City of Baltimore as the other provider of block grant funds for the projects.

## 2. POLICY CONCERNS

***A. The current policies of the State and the City indicating that bond proceeds are to pay for individually identified and approved school projects.***

### **State Impacts**

A block grant program would require modifications in the policies and practices of the Interagency Committee on School Construction. The current State practice, consisting of allocations made to individual projects, provides a very high level of scrutiny at a number of stages in the life of a school construction project. In the interest of protecting the investment of taxpayers in school facilities in Baltimore City, it is critical that these procedures remain in place under a block grant approach.

### **IAC Procedures**

- ***Application for Planning and Funding:*** IAC review determines if the project is justified by enrollments or educational programs and if it is of a type that is eligible for State funding participation; it establishes a budget figure for the State funding participation in the project; and it clarifies the relation of the project to other State policies, e.g. Smart Growth concerns. The approval of the application also indicates to the Maryland State Department of Education Facilities Branch and the Department of General Services School Construction group the likely schedule of submissions for design review. The application process is also used to determine how deficiencies found through the PSCP Maintenance Inspection Program will be addressed by the LEA through local and/or State-funded projects.
- ***Educational Specification:*** For major projects, review by the MSDE Facilities Branch determines if the project will meet standards of good educational design as well as a small number of State design requirements. Submission of the educational specification is a pre-condition for approval of funding in the CIP.
- ***Design Review:*** For major projects and many smaller renovation and addition projects, whether State-funded or not, schematic design review allows MSDE Facilities Branch to determine if the design fully supports the educational specification as well as good architectural practice for educational facilities. For all State-funded projects, review by the DGS Schools Group of design

development and construction documents determines if the project design is in accord with the approved schematic design and/or with good building performance standards, construction methodologies, and bidding document standards for consistency and completeness. This review also ensures that State requirements regarding competitive procurement, minority business enterprise participation, prevailing wage rates, and high performance building requirements are applied where mandated.

- **Contract Approval:** IAC approval ensures that the project has been competitively procured and that MBE requirements were followed, and in some instances leads to a revised calculation of State funding participation based on the actual contract cost as well as the pricing of items in the contract that are ineligible for State funding participation.
- **Change Orders:** Review by DGS allows the State to determine if the original contract scope is adhered to, as well as to calculate State participation in any eligible items for which State funding is available within the original allocation.
- **Requisitions for State Funding:** Administrative approval by PSCP provides a status update on the project and monitors MBE participation throughout much of the active stage of construction.
- **Project Close-Out:** Review by PSCP determines the final State funding participation in a project and ensures that MBE requirements were fully met throughout the life of the project. (Note: since no requisitions are submitted by the LEA once State funds are exhausted, the close-out is the only way to determine the total impact of change orders and the MBE participation for the entire project.)
- **Audit:** PSCP audits provide a general review of LEA practices regarding procurement, financial management, change orders, MBE participation, and other practices, as well as a project-specific assessment of how well projects were managed.

These multiple stages of State review and analysis, while cumbersome, not only protect the State financial investment and other important State interests in the project, they provide professional inputs to the LEAs that have proven to be helpful in planning, designing, procuring, and constructing school facilities in the most effective and economical manner possible. In addition to the project-related actions, the IAC is involved in continuous professional communication with the LEAs on a variety of topics: resolution of contract disputes, best practices in design and construction, bidding strategies, MBE requirements and best practices, etc. The IAC also plays a critical role facilitating communication among the LEAs on best practices, and between the LEAs and other State agencies on issues that may be relevant to their work.

Discussion will take place between the staff of the IAC and of City Schools to establish reasonable modifications to the IAC procedures to allow the block grant approach to be implemented. Although the IAC has an excellent working relationship with the Chief Operating Officer and his staff, there are many operational concerns that must be addressed. The following highlights the most prominent of these urgent concerns:

- Establishment of enrollment justifications for projects, based on better utilization of existing facilities.
- Correction of State Rated Capacities (SRC) for individual facilities, including accounting for use of space by community groups. The reduction of the capacity of schools that are requested for State approval as well as of the school system as a whole will allow more projects to become eligible for State funding.<sup>v</sup>
- Coordination between the Chief Academic Officer and the staff of the Chief Operating Officer in the development of educational specifications, which serve as the basis for all subsequent design decisions.
- Appropriate review of design documents at all stages of development.
- Adequate City Schools staffing to manage the program.

Under an assumption that, irrespective of the method used to fund school construction, the Interagency Committee as well as the City of Baltimore have obligations to protect taxpayer funds as well as the health, safety and welfare of school occupants, the proposed procedures and practices to be used to manage the block grant program are of crucial importance. Baltimore City Public Schools has presented a management structure in Chapter IV. This structure is currently under review by the staff of the IAC. In whatever manner the management process is ultimately structured, it will be important for all procedures to be memorialized in a memorandum of understanding or similar instrument that will be binding on future staff and administrations, since within the 10 years of contracting and the subsequent years of repayment there may be changes of personnel and administrations.

***B. The current policies of the State and the City indicating that bond proceeds are to pay for capital assets rather than for operating expenses, such as the debt service of a third party issuer.***

The current State policy is based on the principle that long term debt should be used to pay directly for long-term assets rather than for either operating expenses or for short term building repairs and improvements. The proposal to utilize State bond proceeds as part of a revenue stream to pay for bonds issued by the Building Authority or a third-party entity to finance school construction

improvements would require a change to the current State policy regarding the use of State bond proceeds. As a practical matter, the State uses its bond proceeds to pay for capital assets that have a functional life of 15 years or longer, the duration of State general obligation bonds. These assets include land, new or renovated buildings, and equipment.

During the 10-Year Plan's projected construction period of 8-10 years, and as long as construction is proceeding, State bond proceeds will be used to pay for a portion of current construction expenses. Because the funds would reimburse current construction expenses, a block grant that consists of State bond funds would be used in a manner that is consistent with the current policy. After the completion of construction, however, block grant funds, including State bond proceeds, would be used to pay debt service costs. It is this use of State bond proceeds that represents a change from current State policy.

The State primarily uses property tax revenue, and occasionally general funds, to pay the debt service cost of its general obligation bond debt. This debt service cost is considered a financing cost, i.e. an ongoing operating expense, rather than a capital asset expense like a lease payment. However, using debt to pay debt service costs incurred through a third-party issuance is conceptually similar to a householder taking out debt to pay for the monthly mortgage obligation. While Section 1.A above outlines legal ways to use State bond proceeds to pay debt service costs of a third-party issuer through a block grant, State policy makers have traditionally not used the State's debt in this manner.

In addition, a long-term commitment to appropriate capital funds for a block grant program that is used to pay debt service, an operating expense, could be viewed as creating a mandated spending obligation. With limited exceptions, appropriation of capital funds has been discretionary, which affords the State the maximum flexibility in addressing its varying capital needs. Depending on the amount of block grants, the duration of the commitment to provide block grants, and the number of jurisdictions ultimately participating in a block grant program, the State's flexibility to address its capital needs in the future may be constrained.

***C. The current policies of the State and the City to manage general obligation debt and all forms of State obligations in order to maintain the State's AAA bond rating and the City's AA bond rating.***

The potential impact on the State's bond ratings and debt affordability of using taxable or tax-exempt bond proceeds under the alternative methods discussed above will not be fully known until an arrangement is actually negotiated among the public body or bodies and the third party bond issuing entity. The impacts may vary according to the actual financing structure selected. There are, however, general conclusions that may be drawn regarding the potential impacts such financing may have on the State's bond rating and debt affordability. Precedent suggests that such issuances of bonds can be structured to allow the use of State grant funds to pay financing costs without negatively affecting the State's issuance of tax-exempt general obligation bonds. Similar remarks apply to the impact of these methods on the City's bond ratings and debt affordability.

### **Debt Affordability**

The key debt affordability question is whether bonds issued by a third party under an alternative method will be considered to be tax-supported debt of the State or City. If the debt is issued through a third-party issuer such as the Building Authority, and clear language is included in the third-party bond offering documents that the third-party bonds are not debt of the State or the City, this issue is substantially mitigated, since the third-party issuer is distanced from the taxing government body. Including statutory language specifying that any debt issued by or on behalf of such third party would not be tax-supported debt would also help to prevent categorization of the debt as tax-supported debt.

Nevertheless, these actions do not necessarily mean that the federal government would not interpret the third-party debt as State or City tax-supported debt for federal tax purposes. For example, State tax-supported debt currently includes debt issued by a third party (e.g., some MEDCO debt issued on behalf of the State), debt supported by State tax revenue (e.g., Bay Restoration Bonds), and debt that the General Assembly has specifically directed to be included (e.g., Grant Anticipation Revenue Vehicles, or GARVEEs). To avoid this consequence, it is essential that the third party issuer must be viewed as being unrelated to either the State or the City.

### **Bond Rating**

In their assignment of the State's AAA bond rating, the rating agencies consider many variables, including the State's direct debt obligations and its ability to pay debt service on those obligations. Although the State may conclude for its debt affordability and accounting purposes that the third-party debt being issued is not State tax-supported debt, the rating agencies conduct independent analyses of debt liabilities and may arrive at a different conclusion based on their interpretation of the State's obligations, including its constitutional obligation to provide public education for its citizens. Variables that would impact the classification of third-party debt as State tax-supported debt include any statutory directive from the General Assembly, the relationship between State tax revenue and the debt services on the third-party bonds, and the relationship between the State and the third-party bond issuer. The extent to which the type of financing arrangement being considered is utilized, in terms of the amount and duration of the State's funding commitment and the number of jurisdictions that receive block grants, and the existence of other sources of revenue to pay debt service on third-party bonds, may also impact the rating agencies' interpretation of the State's obligations. Additionally, any fiscal policy concerns the State may have, such as those discussed above regarding the use of bond proceeds to pay debt service to a third party issuer or the commitment to provide fixed levels of capital funding, may also be shared by the rating agencies.

### 3. ACCOUNTABILITY CONCERNS:

**A. Assurance that schools in Baltimore City that are built through a block grant program will be equivalent in capacity and quality to those built through traditional funding and financing mechanisms.**

**B. Assurance that State and City funds in the form of block grants will be used efficiently, effectively and only for the purposes for which they are granted.**

**C. Assurance that State interests in competitive procurement, minority business enterprise participation, the use of prevailing wage rates, and high performance school buildings will be preserved and protected.**

#### **The Need for a Business Plan**

These three sets of questions under the topic of Accountability point toward the need for Baltimore City Public Schools to develop a thorough business plan before funds are released. All parties – City Schools, the IAC, the City of Baltimore, the advocacy groups - share a common desire to achieve success in carrying out high quality projects in a timely, cost effective way and to manage the large funds involved in the 10-Year Plan in a transparent and thoroughly professional manner. The potential liabilities of such a large funding program should not be underestimated. In 2005 the New Jersey Office of the State Auditor found that the New Jersey Schools Construction Corporation, a subsidiary of the New Jersey Economic Development Authority (EDA), did not establish a thorough business model when it implemented the \$6 billion Abbott school district program, resulting not only in taxpayer funds that were inefficiently used or were not accounted for, but also in a loss of credibility for the program. The audit report states:

*...the Corporation did not have an adequate system of internal controls to properly manage the projects and function in the most efficient and economical manner....the Corporation did not have a project management information system in place which would assist in the oversight of its operations.*

*When the EDA and the Department of Education (DOE) were assigned the task of implementing the requirements of the Act [the Educational Facilities Construction and Financing Act of 2000], an overall strategic plan was not formulated to determine how to best spend the \$6 billion in the Abbott districts....*

*In addition, a comprehensive budget and project cost system was not developed, which would permit budget versus actual cost comparisons....The lack of such a system made it inherently difficult for the Corporation to control individual project costs, and prevented the board from properly monitoring the impact of all project costs, in their totality, on the financial position of the Corporation.*

### **Components of a Business Plan**

A block grant program established in Maryland can avoid the pitfalls experienced in New Jersey by implementing a thorough and well conceived business plan. The business plan must include, at a minimum, the four major components outlined below. Each component has a number of sub-components, many of which are already in process:

#### **1. *The Educational Vision:***

- Types of educational programs City Schools intends to implement
- Geographic distribution of the programs
- Relationship of the programs to current and proposed resources, including facilities
- Generalized educational specifications that will guide facility decisions and designs
- Relation of the educational vision to the City of Baltimore comprehensive plan
- Community input process

#### **2. *The Master Facility Plan* (10-Year Plan)**

- Description of facility needs
- Methodology for prioritizing projects
- Methodology for development of individual project educational specifications, including method for incorporating input from educators, end users and the community
- Method for developing design standards
- Method for determining facilities to be closed
- Generalized timeline of school projects by year, including anticipated phases of planning, design, construction, and occupancy
- Methodology for developing the annual Capital Improvement Program
- Methodology for adjusting the Master Facility Plan on an annual or bi-annual basis to respond to emergent conditions (changing demographics, new educational priorities, legislated mandates, federal or state funding opportunities, etc.)
- Methodology for addressing emergency conditions
- Plan for maintenance of facilities
- Relation of Master Facility Plan to the City comprehensive plan
- Community input process

#### **3. *The Financial Plan***

- Composition of financial oversight group: Board of School Commissioners, City officials, State officials, members of the public
- Authority of the financial oversight group

- Estimated total program cost, inclusive of finance costs, planning and design expenses, land acquisition, construction, furnishings and equipment, move-in, project close-out, and contingency for unanticipated delays, code changes, changes in scope, and unforeseen conditions
- Estimated total costs of individual projects within the block grant program: preliminary estimates, design estimates, estimates during construction, post-construction evaluation of costs
- Estimated cost of other anticipated capital improvements (routine and preventative maintenance items)
- Cost of City Schools staffing and other resources needed to manage the program
- Schedule of anticipated annual expenditures vs. anticipated annual revenues
- Financial control procedures for:
  - Developing accurate project estimates, inclusive of all costs and construction cost escalation
  - Approval of project budgets before procurement
  - Approval of contracts: program managers, construction managers, contractors, design consultants, other consultants
  - Approval of change orders and extensions of fees
  - Financial close-out
  - Updating all cost estimates and revenue projections on a periodic basis
- Reporting requirements: to the financial oversight group, to the Board of School Commissioners, to the City of Baltimore, to the IAC, and to the General Assembly.

**4. *The Management Plan for Capital Projects***

- Composition of management oversight group: Board of School Commissioners, City officials, State officials, members of the public
- State oversight responsibilities: project approval, design review, contract approval, change orders, MBE requirements, close-out
- Program management structure: BOC staff, private sector consultants
- Individual project management structure: BOC staff, private sector consultants
- Selection of design and other consultants
- Quality control methods for design and construction
- Minority Business Enterprise plan
- Criteria for selecting the procurement method for individual projects (competitive sealed bid, competitive negotiation, Quality Based Selection, other)
- Criteria for selecting the delivery method for individual projects (general contracting, construction management agency, construction management at-risk, fast track, other)
- Approval of contracts by BOC, IAC, others
- Approval of change orders and extensions of fee
- Approvals of requisitions and invoices
- Real-time project tracking mechanism

- Default procedures
- Control of warranties, operational and maintenance (O&M) requirements
- Reporting requirements

The business plan should be presented to the IAC, the City of Baltimore and the legislative committees of the General Assembly at various points not only for helpful feedback, but also to ensure that the concerns of legislators and others are addressed. It is also important for City Schools to engage the design community and the contracting community as the business plan is developed to ensure that the methodologies being proposed for planning, design, and construction of the facilities are feasible and can be realized within the proposed timelines.

Finally, the IAC believes that it would be advisable for City Schools to consult with other public owners and school building authorities that have carried out large school construction programs within compressed timeframes to incorporate lessons learned with regard to the four topic areas outlined above. Such owners may include the Greenville, South Carolina Board of Education and the Building Equity Sooner for Tomorrow (BEST) third party corporation; the New Jersey School Development Authority; the Buffalo, New York Board of Education and the Joint School Construction Board; and the Indianapolis, Indiana Board of Education. The programs associated with these governing bodies are described in Chapter VI.

### **THE INSTALLMENT PURCHASE AGREEMENT**

Under any of the alternative funding methods described in Chapter II, “Structuring the Block Grant Program,” the use of an installment purchase agreement (IPA) may prove to be a useful mechanism. In an IPA, the annual appropriations of funds are used to purchase portions of the financed assets over the life of the bonds; the remainder of the assets are owned by the third party bond-issuing authority until the obligation is extinguished. In an IPA, the public’s interest in the facility may be divided or undivided.

- *Undivided interest* means that the public shares an interest in an entire facility with the issuing entity; the percentage of the public’s interest will increase annually, and the public’s interest will be 100% when the debt obligation is extinguished.
- *Divided interest* means that there could be an actual demarcation between the private vendor’s interest and the public’s interest in the financed buildings, with the demarcation changing annually until full interest is with the public at the date that the obligation is extinguished.

In the Greenville, S.C., approach, described further in Chapter VI, the school district took an annual undivided interest in the completed facilities equal to 1/25<sup>th</sup> of the total value, with provisions for “partition” of the assets in the event funds ceased to be appropriated. Under this partitioning, the private vendor retained interest in the most valuable buildings until the end, thus providing some

incentive for appropriations to continue. As an alternative to the Greenville approach, groups of assets can be purchased, for example according to a pre-agreed schedule by buildings or by locations.

In practice, neither a divided nor an undivided interest arrangement will prevent the public from using the school for the usual purposes, both educational and non-educational. The rights and obligations of all parties would be specified in the IPA. From the perspective of the tenants, the building will be available for full use and enjoyment. Issues that must be addressed in the agreement include custodial and maintenance operations; capital repairs and improvements; insurance; and security.

The critical question is what happens if either party defaults: how are the interests divided, i.e. how do ownership and interests transfer to the other party so that the school can stay in operation? This is an issue to be negotiated with the issuing entity in an IPA. For example, included in the 10-Year Plan could be a schedule identifying the sequence for transferring the assets (with the most valuable assets being transferred last so that the investors retain ample collateral). Specific assets could be identified each year for transfer from the investors to the public; this will account for changes in plans (new educational mandates, shifting demographics) as well as inevitable changes in construction schedules.

## **CONCLUSION**

Through the research carried out by the workgroup, the IAC has found that legal precedent exists for the State to use the proceeds of tax-exempt bonds to support a third party authority for specific categories of capital projects. The proposal to establish a Baltimore City Building Authority for the construction of schools in Baltimore City through State legislation may address the question of whether the third-party debt would be viewed as State or City debt, alleviating concerns that this method of financing school construction will have a negative impact on the bond rating or the debt affordability calculations of either governing body. However, that question requires further examination to avoid the negative consequences associated with the State's past experience with several third party debt structures which counted against the state's bond capacity, such as the Bay Restoration debt and GARVEE bonds.

Under the financing method proposed by Baltimore City Public Schools, State funds allocated through the annual Capital Improvement Program in the form of block grants would be used to repay obligations issued by the third party for renovations and new schools in Baltimore City. Accountability for all funds would be of paramount importance, and to that end, statute should specify that a memorandum of understanding will be established between the Interagency Committee on School Construction and the City Schools and possibly the City of Baltimore in order to ensure that schools are built or renovated to meet State requirements and general standards of building quality and performance.

In short, while the complexities of setting up and running this process should never be underestimated, it is the contention of the IAC, based on research conducted by the workgroup, that a method of financing school construction in Baltimore City through a third party authority can be legally created and can be designed to be managed in an accountable manner if adequate resources are directed to the program. The latter point, however, is crucial: neither City Schools nor the State are currently

configured to administer the large number of projects in the 10-Year Plan in a manner that will ensure the project quality, the protection of critical State and local interests, and the accountability that should be expected of a public works program on the scale that is envisioned. It is also important to note that a number of important policy questions related to this financing concept that are raised for the legislature's consideration elsewhere in this report remain to be answered.

## ENDNOTES

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- <sup>i</sup> Letter from Mary Pat Fannon *etal*, Mayor's Office of Government Relations, September 27, 2012.
- <sup>ii</sup> In addition to the financing method described in the body of this report, there are two other methods that will allow State tax-exempt bond proceeds to be used to pay debt service on bonds issued by another entity. Each of the methods is discussed in further detail below. The Common Features of All Alternative Financing Methods described on page 4 of this chapter also apply to these alternatives. The two alternative methods are:

### ***Summary of Alternative Methods:***

**Alternative Method A: Provide Funds Through the Current Structure.** The State could provide a guaranteed level of funding annually to the Board of School Commissioners. During the projected 8 to 10-year construction period, no changes in policies or practices would be required. After the completion of construction, changes in policy and practice would be required, and two alternative scenarios for the post-construction period are described below, one in which State funds are provided to the Board of School Commissioners to pay for debt service, the other in which the funds are granted to the Commissioners in order to acquire ownership interests under an installment purchase agreement (IPA).

**Alternative Method B: Provide Grants to Baltimore City.** The State could make the guaranteed level of annual capital grants to Baltimore City rather than to the Board of School Commissioners. This involves a change in the State funding policy for school construction, but it avoids federal tax consequences for the State, i.e., State tax-exempt bonds would not be considered refunding bonds in this arrangement. However, since the federal tax consequences avoided by the State could be transferred to the City, the analysis discusses the City's views on the matter.

**Alternative Method A: Provide Funds Through the Current Structure:** The State could provide a guaranteed level of funding annually to the Board of School Commissioners.

**During the projected construction period** of 8-10 years, and as long as construction is proceeding, this arrangement would use the current IAC/BPW approval process and the current funding structure: the State will allocate funds directly to the Board of School Commissioners as a reimbursement for a portion of current construction expenses. Although the funds would be approved by the Board of Public Works on a block-grant basis, procedures for the approval of individual projects by the IAC would ensure that all of the funds are allocated for eligible project expenses. Because the funds would be reimbursing current expenses, the State tax-exempt bond funds would not be considered to be paying debt service to a third-party issuer during this period of the construction program.

**Following the completion of construction,** there are two alternative scenarios for the use of State tax-exempt funds:

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**Scenario 1.** The Board of School Commissioners will use the State funds to pay debt service to the third party issuer (or to pay its own bond debt service).

Pro:

- During the construction period, this alternative preserves the 40-year old State funding arrangement for school construction, including control and accountability via the IAC. Although the funds would be allocated in a block grant, the determination of individual project eligibility, design review, contract approvals, review of change orders, and project close-out would follow current practices (see Chapter IV on JCR Topic 4).

Con:

- In order to comply with federal tax laws, during the post-construction period the State, the City, and the third party issuer will be required to coordinate the structure and timing of the State tax-exempt bond issues with the structure and dates of the debt service payments of the third party issuer.
- It is likely that the State tax-exempt bond proceeds allocated to the Board of School Commissioners would be considered to be refunding bonds for federal tax purposes.
- In this case, the debt issued by the third party is also more likely to be viewed as State debt.
- This alternative will require major changes in the policies and practices that govern the State funding arrangement for school construction, since State tax-exempt bond proceeds will be used to pay debt service, rather than to acquire school assets.

**Scenario 2.** The State tax-exempt bond proceeds allocated to the Board of School Commissioners will be used to make payments under an IPA to acquire ownership interests in already-completed school projects.

Pro:

- The State bonds are not likely to be viewed as refunding bonds:
  - The arrangement can be construed as use of State tax-exempt bond proceeds to acquire an asset.
  - Payments can be made to purchase certain assets or partitioned assets or an undivided interest in the assets.

Con:

- This arrangement raises questions related to partial ownership of the facility, potential tax implications for the City, the role of the Board of School Commissioners, and the costs of establishing a third party to issue the bonds. These questions can be addressed through the agreement that is established among the State, the City, the Board of School Commissioners, and the third party issuer.
- An IPA must be in place at the outset of the project, to be negotiated among four parties: the State, the City, the Board of School Commissioners, and the third party issuer.
- The IPA method represents a change from the traditional State funding arrangement for construction of school facilities: State tax-exempt bond proceeds will be used to acquire partial interests by the Commissioners in already-constructed school projects.

**Alternative Method B: Provide Grants to Baltimore City:** The State could make the guaranteed level of annual capital grants to Baltimore City rather than to the Board of School Commissioners.

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Pro:

- Because the City is not a related entity to the State (i.e., it is a sovereign entity), from the federal tax law perspective the funds are considered to be a grant and are expended once they are granted.
- There is precedent in State government for this approach in the grants made through bond bills to municipal and county governments (however, there is limited precedent within the school construction arena).
- The arrangement gives flexibility to the City to use the grant funds in any way it wants: through an installment purchase arrangement involving a 63-20 or other bond issuer, or as direct payment for construction. (Note: the City does not need additional authority to establish a 63-20 corporation.)
- Negotiations with the issuing entity are simplified, since they will involve only two parties, the City and the bond issuer; the State will not make a third party to the negotiations.
- State requirements on competitive procurement of construction, minority business enterprise requirements, prevailing wage rates, and high performance schools, as well as the IAC's review of projects, awards of contracts, and other duties, can be incorporated into the terms of the grant.

Con:

- This is a significant change in State policy: in addition to the change involved in the granting of capital funds as a block grant rather than as a project-by-project allocation, the funds will be allocated to a local government rather than to a board of education. There would need to be significant changes in the operations of the City and in many cases a duplication of structure in the city and the School system, and numerous other complications related to the rating of the city bonds, consideration of all of the Baltimore City Public School debt obligations as obligations of the City. It was determined that this is not an option that should be considered.
- Questions that must be addressed include:
  - Which party will issue the debt?
  - How will the City make the funds available to the Board of School Commissioners?
  - How will the program be managed?
- If the City rather than the school system manages the funds, mechanisms must be developed to allow City Schools to exercise control over decisions that could affect the educational program, design and construction quality, or the long-term maintenance and operations for which they will be responsible.
- The City notes that "this method would create arbitrage, reimbursement and refunding complications for the City and might affect the City's debt rating and bond affordability. All of the State's tax concerns...are transferred to the City...and risk a downgrading of our bond rating. The debt issued in support of BCPS. The debt issued in support of BCPS innovative construction program must not be the debt of the City."
- The City also notes that the burden for compliance with the State's requirements on competitive procurement, MBE participation, prevailing wage rates, and high performance schools, all of which is now assumed by City Schools, would transfer to the City, and that it does not currently "have adequate resources to undertake these responsibilities."

iii Analysis of Maryland Courts Regarding Boards as Agents of the Court. The Maryland Court of Appeals has consistently held that a Board is an agency of the State. The courts of Maryland have repeatedly supported this conclusion with the following analysis:

1. Maryland law creates the Boards and governs their composition and membership. Education Article §§ 3-103, 3-105, 3-108, et seq. The statute requires the Boards to "carry out the applicable provisions of [the Education Code of Maryland] and the bylaws, rules, regulations, and policies of the State Board [of Education]." Education Article §4-108. The Boards must obtain the State's approval regarding the establishment of schools, acquisition or disposition of property, construction or renovation of buildings,

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and curriculum. Education Article §§ 4-109, 4-111, 4-115. The State appropriates substantial funds to support the Boards. Education Article §§ 5-201 – 5-206. In return, the Boards must acquiesce to an annual audit and submit an annual budget to the State. Education Article §§ 5-101, 5-109, 5-110.

2. Boards are creatures of the General Assembly. Education Article § 3-103 creates a Board for each County, with limited authority to control educational matters that affect the County. See Education Article § 4-101. In eighteen Counties, the members of the Board are elected by the voters of the County. Education Article §3-114. In Baltimore City, the members of the Board, other than a student member, are appointed jointly by the Governor and the Mayor of Baltimore. Education Article §3-108.1. In the other Counties, the members are appointed by the Governor from among the residents of the County or by a combination of election and appointment. Education Article § 3-108. The County school systems are funded in part by the State and in part by the Counties. *Hornbeck v. Somerset Co. Bd. Of Educ.*, 295 Md. 597, 458 A.2d 758 (1983). Although in terms of their composition, jurisdiction, funding, and focus, they clearly have a local flavor, the Boards have consistently been regarded as State, rather than county, agencies. See *Bd. of Ed. v. Montgomery County*, 237 Md. 191, 197, 205, A.2d 202, 205 (1964); *McCarthy v. Bd. Of Education of A.A. Co.*, 280 Md. 634, 374 A.2d 1135 (1977); *Bd. Of Educ. v. P.G. Co. Educators' Ass'n*, 309 Md. 85, 95 n.3, 522 A.2d 931, 936 (1987); *Montgomery Co. Ed. Ass'n v. Bd. Of Educ.*, 311 Md. 303, 317, 534 A.2d 980, 987 (1987); *Board v. Secretary of Personnel*, 317 Md. 34, 44 n.5, 562 A.2d 700, 705 (1989); *Board v. Town of Riverdale*, 320 Md. 384, 387 n.3, 578 A.2d 207, 209 (1990); *State v. Board of Education*, 346 Md. 633, 640, 697 A.2d 1334, 1338 (1997); *Chesapeake Charter v. Board of Ed.*, 358 Md. 129, 747 A.2d 625 (2000); *Alternatives Unlimited v. New Baltimore City Board of School Commissioners*, 155 Md.App. 415, 843 A.2d 252 (2004); *Norville v. Board of Education*, 160 Md.App. 12, 862 A.2d 477 (2004), vacated (but not with respect to the agency issue) 390 Md. 93, 887 A.2d 1029 (2005); *Patterson Park Pub. Charter Sch., Inc. v. Balt. Teachers Unions, AFT, Local 340, AFL-CIO*, 399 Md. 174, 923 A.2d 60 (2007); *Zimmer-Rupert v. Bd. Of Educ.*, 179 Md. App. 589, 947 A.2d 135 (2008); *Bd. Of Educ. v. Beka Indus.*, 190 Md. App. 668, 989 A.2d 1181 (2010) *aff'd in part, rev'd in part on other grounds*, 419 Md. 194, 18 A.3d 890 (2011); *School Commissioners v. Koba*, 194 Md. App. 400, 5 A.3d 60 (2010).
3. Boards are considered generally to be State agencies because: (1) the public school system in Maryland is a comprehensive State-wide system, created by the General Assembly in conformance with the mandate in Article VIII, Section 1 of the Maryland Constitution to establish throughout the State a thorough and efficient system of free public schools, (2) the Boards were created by the General Assembly as an integral part of that State system, (3) the Boards' mission is therefore to carry out a State, not a County, function, and (4) the Boards are subject to extensive supervision by the State Board of Education in virtually every aspect of their operations that affects educational policy or the administration of the public schools in the County.
4. Although the Boards are generally regarded as State agencies because they are part of the State public education system, are subject to extensive supervision and control by the State Board of Education, and exercise a State function, from a budgetary and structural perspective, they are local in character. They are subject to the County, not the State, budget process and must justify their budget to the County government.
5. The one area in which the Legislature has expressly subjected Board procurement to supervision and control by the Board of Public Works (BPW) is school construction, and that is because, during the last four decades, the State has paid for a large portion of the cost of that construction. See Education Article § 5-301. The BPW is authorized to adopt regulations and procedures for the school construction program, and both the County governments and all of the educational agencies, including the Boards, are expressly made subject to those regulations. Education Article § 5-301(g). That authority is not pursuant to the General Procurement Law, however, but arises from provisions in the Education Article, and it is not complete. The Boards still let the contracts in accordance with Education Article § 5-112. See 76 Op. Atty. Gen. 181, 183 (1991).

<sup>iv</sup> Bond counsel for the State Treasurer's Office has determined that if bonds are sold within 18 months of final payment to the contractor, the tax-exempt status of the bonds is not impaired. In practice, this means that if

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final payment to a contractor for public school construction is made after March 1<sup>st</sup> following completion of the work, the LEA can request funding in the CIP for the following autumn; since the bonds for approved projects will be sold in August of the following calendar year, they will fall within the 18 month timeframe specified.

v In order for a school to receive State funding for capital projects, there must be a reasonable likelihood that the school will remain open for at least 15 years following completion of the project, that is, for the nominal life of the improvement. As a guideline, if a school has a projected utilization of less than 60%, the staff of the IAC will request further information about the school to determine if it State funds should be invested in a facility that might close. Although there are a number of possible reasons that might support State investment, in general it is more difficult to support State investment when there is a large amount of excess capacity in a school system.

vi <http://njleg.state.nj.us/legislativepub/Auditor/90195.pdf>

## CHAPTER III: THE IMPACT OF A BLOCK GRANT PROGRAM

**JCR Topic 3: Assess the implications of providing, or not providing, a block grant to improve Baltimore City’s school facilities as expeditiously as possible, and the impact on the Public School Construction Program as a whole and on other counties**

### INTRODUCTION

City Schools has proposed the implementation of a 10-Year Plan, the School Modernization and Renovation Transformation (SMART) program, to address the school system’s \$2.4 billion backlog of capital investment. The 10-Year Plan proposes to take advantage of historically low interest rates and construction costs by accelerating the design and construction activities so the program is completed in a ten-year period. Acceleration of school construction projects on a large scale requires, however, that a large allocation of funds be made available in a relatively short time frame, a task that is not possible using existing State and City fiscal mechanisms. This large, short-term allocation would need to be repaid through a long-term revenue stream; one mechanism for accomplishing this proposes to leverage governmental capital funding streams to obtain up-front capital funding from the financial markets through the use of block grants and installment purchase agreements or the other types of financing transactions discussed in Chapter II, “Structuring the Block Grant Program.”

This chapter examines:

1. The impacts of the use of a block grant for City Schools, including a comparison of costs of a sample construction program using traditional funding with block grant leveraging of funds;
2. The implications of not providing a block grant to improve the facilities in City Schools as expeditiously as possible; and
3. The impacts of the block grant program on the school construction program, on other school systems, and on the IAC.

### IMPLICATIONS OF THE BLOCK GRANT PROGRAM

**JCR Topic 3: Assess the implications of providing, or not providing, a block grant to improve Baltimore City’s school facilities as expeditiously as possible**

#### Traditional vs. Block Grant Structures

Traditional government funding in Maryland for school capital projects has been based on annual appropriations for specific school projects using a “project-by-project” funding structure. Capital funding streams in a fiscal year are used for direct construction expenditures made for approved capital projects in that same fiscal year. State procedures and regulations support the project-by-project

appropriation method. The analysis in Chapter II, however, shows that Maryland statute allows the use of block grants for capital projects.

### **Summary of Impacts of Block Grant Funding**

Five potential outcomes for City Schools are associated with the block grant approach:

1. Reduce the timeframe of program completion;
2. Reduce the impact of construction cost escalation;
3. Improve the Facility Condition Index and the Educational Adequacy Score;<sup>i</sup>
4. Reduce operating, maintenance and utility costs; and
5. Allow the use of cost saving construction management methodologies used in the private sector

#### ***1. Reduce the Timeframe of Program Completion***

The first benefit – reducing the timeframe of program completion – occurs because the block grant approach allows the private capital market to provide up-front funding. Private investors require a high level of security that their investments are backed by a reliable funding stream. Under the current State practice of funding schools on a project-by-project basis, funding amounts allocated to an LEA may fluctuate from year to year. Moreover, project-specific funding means that the final annual funding granted to the school system will depend on the outcome of each particular project; changes in the bidding climate, deduct change orders, or other alterations of project scope or cost could reduce the State’s annual allocation. Finally, the project-specific method does not allow funds to be flexibly moved from one project to another; instead, a complex process of reallocation through the Interagency Committee on School Construction and the Board of Public Works is required to move funds, and in no case can the total allocation for a project exceed the amount that was originally determined at the time of project approval in an annual capital improvement program. By contrast, a State block grant in an annual amount that is fixed by statute is thought to provide the security, flexibility, and predictability that is required by private investors in a large, up-front bond issuance.

Concentrating the timeframe for construction through a block grant approach would allow the school system to build new schools and fully renovate old schools, in contrast to the current approach of patching leaks and making temporary repairs, such as placing new equipment into old systems. With adequate upfront funding in combination with a robust management structure (see Chapter IV), City Schools will work on multiple projects simultaneously, thus reducing the full program timetable.

While the traditional method of project-specific funding caps the amount of construction activity each year by the amount of annual funding received, the block grant financing method will leverage the annual City and State allocations into approximately 15 times the amount of project spending.<sup>ii</sup> According to City Schools’ financial advisor, the Public Resources Advisory Group, \$66 million in annual funding would leverage approximately \$1 billion net of construction revenues, assuming four consecutive annual financing transactions with interest rates ranging from 4% to 5.5%. In one scenario that was discussed by the workgroup, \$32 million of State block grant funds, \$15 million of City block grant funds, \$8 million of bottle tax revenues, \$2 million of video gaming revenues, \$2 million of table

games income and \$7 million of City retiree health payments would provide the combined annual revenue stream of \$66 million. These State and local revenue streams depend on a variety of future circumstances, including legislative approval; however, for purposes of illustration this chapter will use the annual figure of \$66 million to demonstrate the effects of the block grant program in comparison to traditional funding.<sup>iii</sup>

## **2. Reduce the Impact of Construction Cost Escalation**

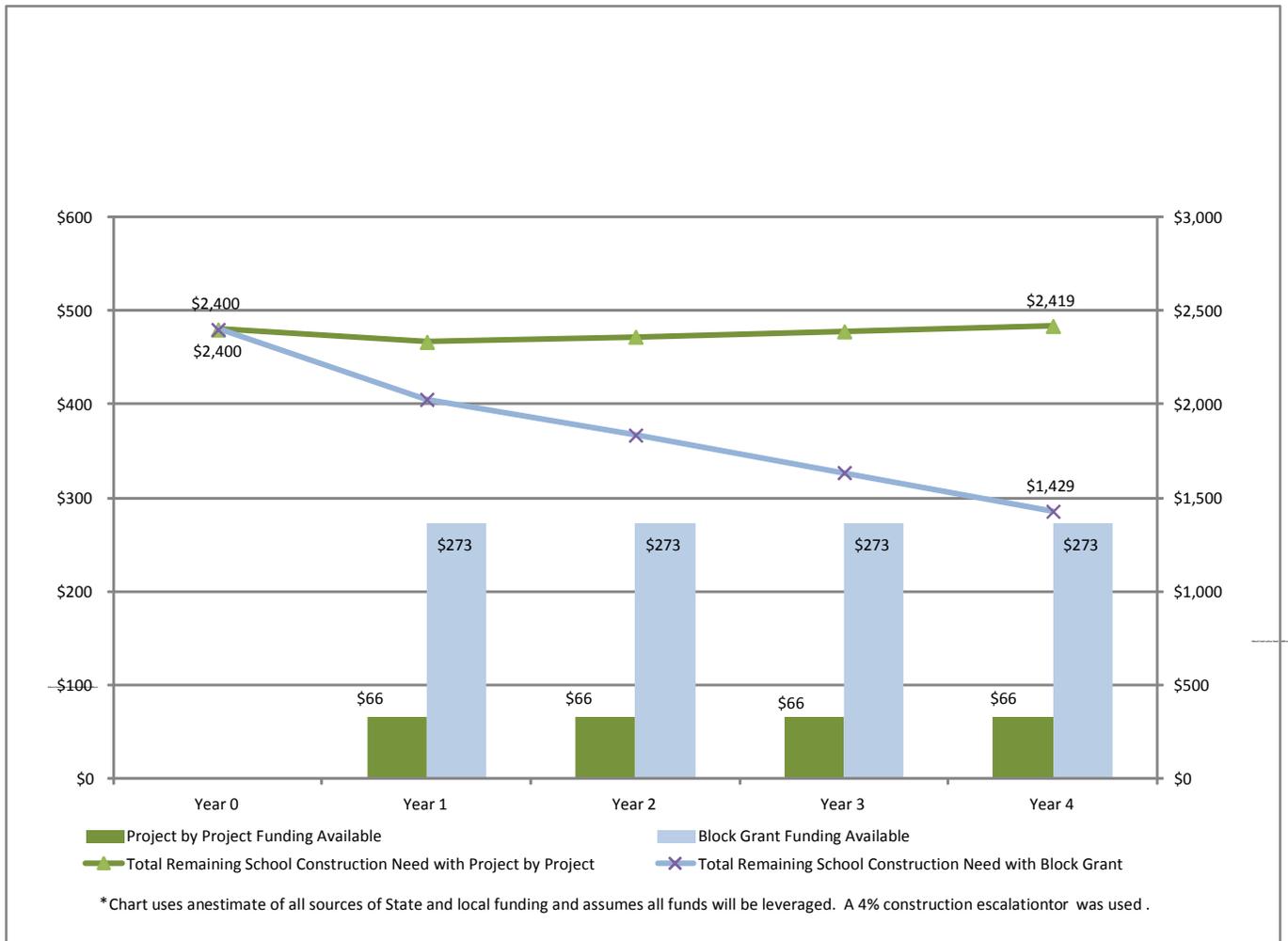
Shortening the timeframe of program completion means that the impact of construction cost escalation will be lessened.<sup>iv</sup> Exhibit 1 below shows the comparison of using a block grant approach with an annual allocation of \$66 million for the first four years of construction, versus the current project-by-project funding system. The average annual spending of \$273 million shown in Exhibit 1 is based a 10-year program to address the \$2.4 billion need identified in the Jacobs Report, and assumes a 4% construction cost escalation rate.<sup>v, vi</sup> Funding for the first four years of the ten-year program, which would address approximately 41% to 45% of the school facilities needs, could be supported with a 30-year pledge of the \$66 million of existing and proposed funding streams via an alternative financing arrangement.

The chart below projects that the total school construction need for Baltimore would be significantly reduced from \$2.400 billion to \$1.429 billion over the first four years by leveraging city and state annual funding through alternative financing. Under the current funding system, the total need would actually increase over the same time period to \$2.419 billion due to construction cost escalation: if \$66 million is provided annually, then the deficiencies are reduced by approximately 3% per year while construction escalation adds 4% to the balance each year, resulting in a net increase in total cost over four years.

In South Carolina, the Greenville County Public Schools building program, described more fully in Chapter VI, was designed to avoid the negative impacts of construction escalation costs. Under the traditional project-by-project system, the school district estimated that it would take nearly 40 years to complete all the necessary renovations and additions to bring all school buildings in the district up to modern standards at a cost of \$3.21 billion, assuming 5% construction cost escalation. The school district projected that if the construction cost escalation average had been 6%, it would have taken over 50 years to complete the same set of improvements, increasing the cost to almost \$5 billion. In order to avoid these cost increases and improve the conditions of buildings in a reasonable amount of time, Greenville fast-tracked its school construction program by generating a large amount of upfront funds through financing transactions. The Building Equity Sooner for Tomorrow (BEST) program asserts that using an installment purchase alternative financing model, Greenville's plan fully renovated or built 80 new schools in six years at a cost of just over \$1 billion, with an estimated savings of \$1 billion. The savings were reported to have been achieved through avoidance of construction cost escalation in combination with bulk purchasing methods and cost effective, standardized school designs. Approximately 9,000 jobs were reported to have been created for the community.<sup>vii</sup>

**Exhibit 1** (source: City Schools)

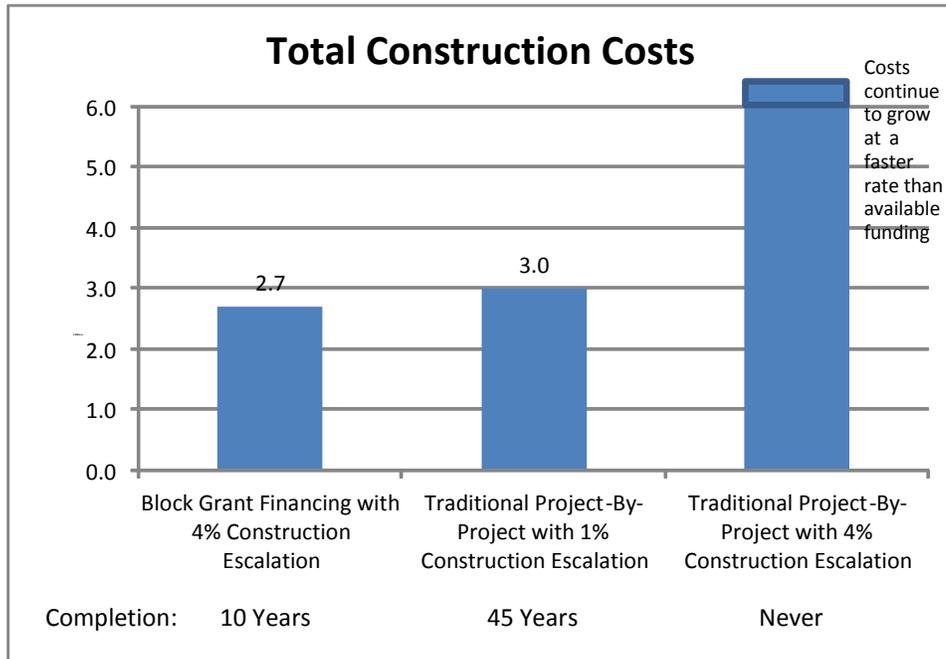
**Four Year Comparison of the Impact of Block Grant Funding vs Project by Project Funding for Baltimore City Public Schools**



The Exhibit below shows that assuming a 4% annual rate of construction cost escalation, the block grant financing option will ultimately cost \$2.7 billion and the construction program will be completed within 10 years. Alternatively, if the traditional funding methodology is used, the construction program can never be completed as the escalation in construction costs each year, using the same 4% growth assumption, will be greater than the available annual funding. Only if the construction escalation rate is at a low 1% will the traditional project-by-project funding option result in a completed construction program. Unfortunately, at this rate of construction the program will not be completed for 45 years.

Exhibit 2 (source: City Schools)

**Construction Cost Escalation Impacts: Block Grant Financing vs. Traditional Project-By-Project Funding**



**3. Improve the Facility Cost Index and the Educational Adequacy Score**

The Jacobs Report provided an assessment of the condition of all district-owned buildings using the Facility Condition Index (FCI; see Chapter I for an explanation of this term). The analysis performed by Jacobs determined that the school system’s overall FCI is 60%, reflecting facilities in very poor condition. As shown in Chapter I, a Facility Condition Index greater than 51% is considered to be very poor.

The Jacobs Report also provided the Educational Adequacy Score (EAS) which represents the degree to which a school system’s facilities can adequately support instructional mission and methods. Unlike the FCI, this is not a nationally recognized measurement, but was established to quantify the adequacy of City Schools for the purpose of the study. It too is measured on a 1-100 percentage scale, where higher scores reflect buildings that are better able to meet educational needs. Jacobs found that the City Schools’ score was 55, a failing grade, since school buildings do not provide the physical structures, technology and instructional space to support 21<sup>st</sup> century teaching and learning.

FCI is a helpful measure of how facility condition is related to various funding scenarios. In September 2011 the Director of Facilities for Wicomico County Public Schools showed that for 28 out of the 35 facilities in the school system, the current overall FCI is 29%.<sup>viii</sup> Under combined current State and local funding in an average annual amount of \$3.8 million, it is projected that the overall FCI of the system will decline to 57% by 2020. In order to maintain the current FCI, \$13.6 million per year in combined

State and local funds will need to be provided. In order to raise the FCI by 2020 to a level of 10%, the annual funding would need to be increased to \$20 million.

Although a similar analysis remains to be carried out for Baltimore City Public Schools using data from the Jacobs Report, it is probable that, similarly to the Wicomico school system, under current funding the overall FCI of the system would worsen within the next ten years. Given the current overall FCI of 60%, the building performance of a majority of schools would remain unsatisfactory: the renovation or replacement of a few facilities will not compensate for the system-wide effects of deterioration. Most important, an extended building schedule would have a negative impact on the educational program of many students. A student who enters kindergarten in the fall of 2012 is very unlikely to leave from a modernized school with adequate building and educational features when he or she graduates in the spring of 2025. To the extent that educational facilities play a role in the achievement, the physical well-being, and the personal development of students, these students will be at a disadvantage relative to their peers in other jurisdictions who may enjoy more educationally suitable facilities.

The Baltimore City 10-Year Plan proposes to carry out all of the prioritized projects within the Jacobs study within four years and to complete the full \$2.4 billion program within 10 years. The annual funding under this program would increase on average from the current \$150 million to between \$250 and \$273 million, an increase of over two-thirds, with a focus on the simultaneous construction of a number of major projects; in contrast, the current approach supports a small number of major projects concurrent with a very large number of individual building system upgrades. If the schedule of improvements in the Plan achieves its goal of renovating or replacing all schools in the system within 10 years, then a student who enters City Schools in the fall of 2012 stands a very good chance of spending at least half of her or his academic career in a facility that meets contemporary standards of building performance and academic suitability.

While the current literature on the relation of facility condition to student achievement is limited and is often specific to narrow findings, it does provide some guidance as to the educational benefits of capital investments. A study carried out in 2003 for Maryland's Task Force to Study Public School Facilities by Dr. Glen Earthman, a leading expert and professor emeritus at Virginia Polytechnic Institute and State University, highlighted five facility factors that have the most significant impact on student achievement: Temperature Control, Indoor Air Quality, Lighting, Acoustical Control, and Secondary Science Laboratories.<sup>ix</sup> Jacobs documented significant deficiencies in all of these factors in numerous City School facilities.

Other studies have shown that in classrooms with temperatures that are outside of the human comfort zone (~67-74F), student productivity, efficiency, and test scores have been found to be significantly lower. When ventilation rates are at or below minimum standards (roughly 15 cfm per student), an associated decrease of 5% – 10% occurs in certain aspects of student performance on tests.<sup>x</sup> Adequate lighting and noise control are also critical environmental factors that impact student achievement. Students have scored between 7 - 18% higher on tests and make progress significantly faster in math and reading in classrooms that receive ample lighting, especially from natural daylight.<sup>xi</sup> Higher student

absentee rates have also been correlated with poor lighting. Recently, a study has shown that when deprived of natural light, children's melatonin cycles are disrupted, thus likely having an impact on their alertness during school.<sup>xii</sup> Other health conditions, such as asthma, are directly affected by poor air quality.

Dr. Earthman noted the most basic of all building conditions to be addressed were those of health and safety. The Jacobs Report shows that there are threats to health and safety that also affect the ability of City Schools to keep some schools open and deliver the educational curriculum throughout the school year. These factors include building safety and code compliance, as well as severely damaged or failing building components. Approximately \$784 million is needed in Baltimore City Schools to correct the highest priority deficiencies in categories titled "Mission Critical Concerns" and "Indirect Impact to Educational Mission" (Jacobs Report, page 21). These deficiencies mostly include aging and faulty HVAC systems, outdated and insufficient electrical systems, structural concerns, roofing needs, and fire and life safety systems. These deficiencies are likely to produce harmful environments - mold and rodent infestation, toxins like PCB and asbestos that are present in old building materials, and the poor indoor air quality that exacerbates asthma. The risk of accidents and illnesses to students and employees will increase if these conditions are not improved. The Jacobs study indicates an additional \$221 million in facility deficiencies that will become impediments to the educational program if not corrected within a reasonable time, \$324 million in enhancements that will affect the educational program within the next five years if not corrected, and \$113 million that are considered to be aesthetic enhancements.

As noted in the Construction Cost Escalation section above, the current and anticipated funding levels within the traditional funding structure will address the facility infrastructure problems in 45 years at best if construction cost escalation rates are limited to 1% per year. The more realistic escalation rate of 4% means the facilities, and therefore the FCI and EAS, will worsen every year, since the current and anticipated funding levels are outpaced by construction cost escalation. The shorter construction period offered by the block grant financing scenario, if it is well managed, will allow City Schools to benefit its students by providing support to an enhanced set of educational programs.

#### **4. Reduce Operating, Maintenance and Utility Costs**

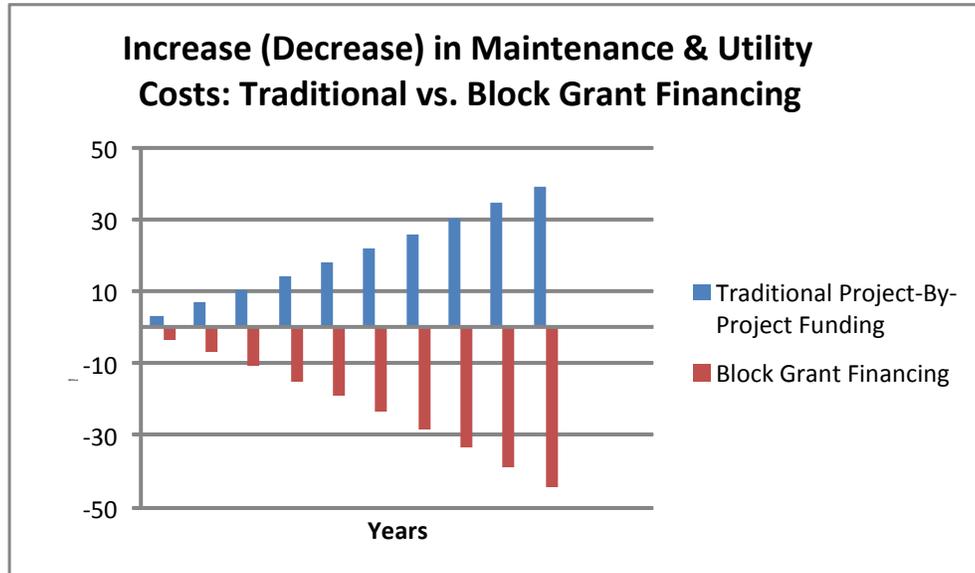
Costs to operate, maintain and repair outdated buildings and equipment grow greater each year, pulling operating funds away from direct education expenses and towards facility expenditures. As with any physical asset, the older the City Schools infrastructure grows, the more significant this shift of resources will become. Today, City Schools spends approximately \$113 million annually on maintenance, repair and utilities. Jacobs Project Management has estimated that by replacing and modernizing the current buildings, City Schools would reduce its annual utility expenses by \$17 million, and through the closure of 24 schools would save an additional \$5 million per year in maintenance, repair and overhead costs. While the current small-project approach undoubtedly reduces some maintenance expenses, inflationary and construction cost escalation factors are likely to outweigh these savings. Under an assumption that operating expenses increase at an average rate of 3% per year, City Schools estimates that by year 10 the maintenance and utility costs will be reduced by \$44 million under the block grant financing alternative, compared to an increase in maintenance and utility costs of \$39 million under

traditional project-by-project funding – a potential differential of \$83 million.. Using these assumptions, Exhibit 3 shows the comparative impact of the two funding structures on operating costs over a ten year period.

**Exhibit 3** (source: City Schools)

**Traditional vs. Block Grant Structures**

**Impact on Operating Maintenance and Utility Savings from Replacement of Outdated Assets**



**5. Use Private Sector Construction Management Methodologies to Reduce Costs**

Another anticipated benefit of the block grant structure is that it can utilize the mass-volume procurement and construction methods of private sector developers and constructors, optimizing efficiencies across many constructed units rather than on a single-building basis. Volume purchasing can reduce the cost of materials and supplies across the whole project, overhead costs are spread among multiple unit projects and funding sources are liquid, with the ability to use funds for any and all individual units as long as the overall development budget is not exceeded. Budget changes, expenditure monitoring and reporting related to one overall construction program also create administrative cost savings. If use of these methodologies can save 1-3% of construction costs, total savings in the \$2.4 billion 10-Year Plan could amount to \$24 to 72 million.

**FURTHER COMPARISON: TRADITIONAL VS. BLOCK GRANT FUNDING FOR A SAMPLE CONSTRUCTION PROGRAM**

City Schools has provided the following example to further illustrate the financial comparison between these two approaches. This analysis assumes an estimated \$1 billion construction program based on anticipated annual government funding of \$66 million and a financing term of 30 years. Interest rates range from 4% to 5.5%, as previously noted. The analysis examines the first \$1 billion phase of a

Baltimore City Schools construction program under a block grant approach. This hypothetical phase aligns with the set of projects prioritized per the criteria outlined in the Introduction (p. 12, described more fully in Chapter VII), and does not reflect the full \$2.4 billion construction program.

Exhibit 4 shows the funding available to complete the prioritized projects under the traditional and block grant structures. Under the traditional structure, only \$66 Million per year may be directly spent on capital projects. After accounting for the annual increase in construction costs, assumed to be 4%, it is estimated that it would take twenty-three (23) years to complete the \$1 billion prioritized capital program. Assuming annual spending under the 10-Year Plan of approximately \$273 million per year, the \$1 billion capital program will be completed within four years. The block grant financing scenario also assumes annual construction cost increases using the same 4% growth rate.

**Exhibit 4** (source: City Schools)

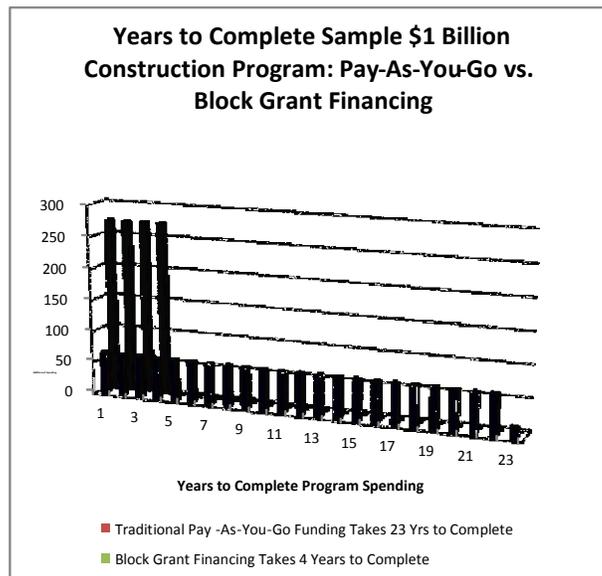


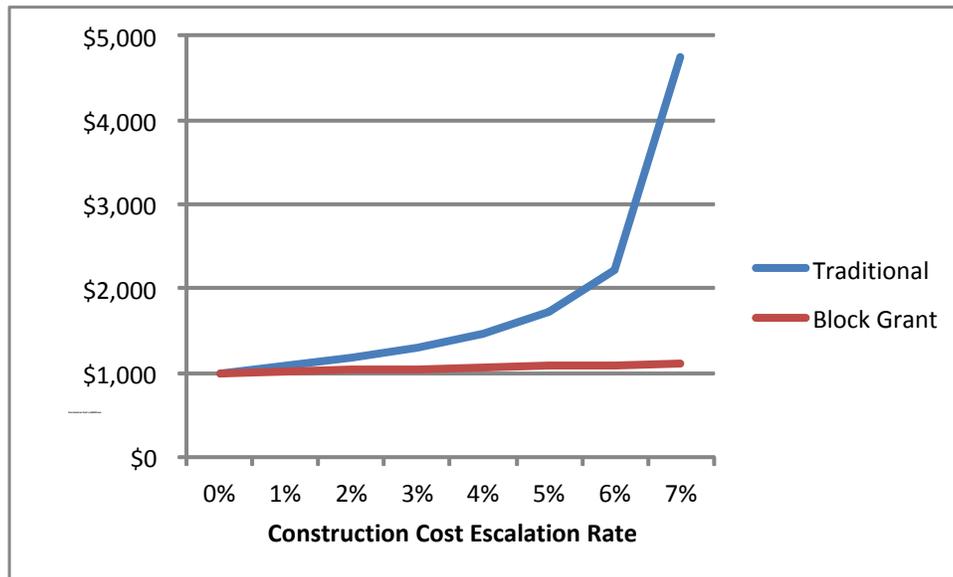
Exhibit 4 also shows the differential construction costs under the two funding scenarios. By summing the bars, the chart indicates that the traditional method of funding yields a construction cost that is \$380 million, or 35% more than the total under the block grant arrangement. This is due to the impact of construction cost escalation over an extended period of time.

Exhibit 5 shows the detrimental impact that higher construction cost escalation rates have on the overall capital program. Because of the compounding characteristic of the rates – a higher rate is applied against costs that have already increased in previous years – a modest increase in the construction cost escalation rate beyond 4% has a very significant effect on the overall cost of an extended construction program. Construction cost escalation is a major risk that must be borne by the owner and that can severely restrict the overall scope of a large construction program; the graph shows that the block grant

structure, by allowing an accelerated construction schedule, minimizes the risk of dramatically increasing construction costs generated from higher construction escalation rates.

**Exhibit 5** (source: City Schools)

**Impact of Construction Escalation on \$1 Billion Program Under Traditional and Block Grant Structures**



**ECONOMIC AND COMMUNITY BENEFITS**

There are potential economic and community development benefits to an accelerated school construction program of the magnitude of the 10-Year Plan:

- The Department of Budget and Management has estimated that 7.2 direct construction jobs and 5.1 indirect jobs are generated by every \$1 million that is spent on construction activity. Direct jobs are those related to job-site activities while indirect jobs are related to the processing and manufacture of building components and related services. Based on this figure, an estimated 8,100 direct construction jobs could be generated through the initial \$1.13 billion of prioritized work in the 10-Year Plan, and as many as 9,300 additional direct construction jobs could be generated through the full build-out at \$2.45 billion. The corresponding figures for indirect jobs are 5,700 and 6,800.

According to the Baltimore Building & Construction Trades Council, there are more than 3,000 unemployed construction workers in the Baltimore area; the statewide unemployment rate among construction workers approaches 15 percent. Local residents and small businesses may benefit through the use of local training partnerships, contractor mentorships for small and women- and minority-owned businesses, and multiple-prime contractor methods that generate scopes of work within the bonding capacity of small contractors.

- The quality of school programs and facilities are understood to play a role in the locational decisions of households. Based on this observation, the Interagency Committee on School Construction in collaboration with the Maryland Department of Planning has developed several policies that support good community planning principles by emphasizing the revitalization of schools in existing communities.<sup>xiii</sup> The 10-Year Plan could make a contribution toward the health of neighborhoods in Baltimore City.

## CONCLUSION

The block grant alternative may, under the assumptions used in this study, provide a beneficial impact in terms of rapid program execution, lower construction cost escalation, rapid improvement to the Facility Condition Index and the Educational Adequacy Score, reduction of operating, maintenance and utility costs, and potential savings through advanced program management techniques. Given the poor current condition of Baltimore City’s school facilities, a delay in large-scale improvements is likely to lead to larger costs to remediate these essential public buildings. The burden for this increased cost will fall on both the State and the City. Since capital funding from both sources will likely be constrained in the foreseeable future, a large investment in City Schools facilities in the near term may help to prevent even larger expenditures at a later time.

Success in carrying out the Baltimore City 10-Year Plan will depend critically not only on the provision of a large amount of funding, but also on how the funds are managed. The New Jersey school construction program stands as a stark warning on the possibilities for mismanagement of a large program (see Introduction page II-14 and Chapter VI, Case Studies, page VI-9). To avoid this outcome, a business plan of the type outlined in Chapter II must be implemented, with concentrated increases in staffing for both the City Schools facility management departments and for the IAC. Potential impacts of mismanagement range from construction of projects that poorly serve the educational program, project delays, use of funds for inappropriate purposes, and impacts on the bond ratings, the debt affordability, and the credibility of the parties involved.

## OTHER IMPACTS

**JCR Topic 3: Assess ... the impact on the Public School Construction Program as a whole and on other counties.**

The block grant initiative has four components that may affect the Public School Construction Program and the school construction programs of other jurisdictions in Maryland: (1) the change of State funding from a project-based annual allocation method to an annual block grant approach; (2) the establishment of a statutorily defined fixed annual allocation amount for City Schools; (3) the impact of the increased Baltimore City 10-Year Plan on the availability and costs of design and construction services; and 4) the extent to which the Baltimore City program may draw resources from the Interagency Committee on School Construction, reducing its ability to respond to the needs of other school districts in Maryland and the Maryland School for the Blind.

## **1. Impact of Block Grant Funding vs. Project-Based Funding**

The use of block grant funding for Baltimore City is not likely to have an impact on other school districts and local governments unless the use of the block grant to repay third party obligations affects the State's bond rating or debt affordability (as described above in Chapter II). Other jurisdictions, notably Greenville, South Carolina, have been able to structure their financing and related real estate transactions so as to avoid negative impacts on their bond rating or debt affordability. However, if the financing arrangement proposed for Baltimore City Public Schools causes either the State bond rating to be reduced or its outstanding debt to increase to unacceptable levels relative to the debt affordability ceiling, then the cost of capital borrowing will increase and/or the State will be required to reduce the amount of its bond issuance.

Other school districts in Maryland would be harmed by either of these outcomes: every jurisdiction in Maryland depends to a greater or lesser extent on a robust level of State capital funding to meet their school construction needs, and if the total amount of State funding is diminished, many projects are likely not to be carried out when planned or may be deferred indefinitely, with obvious implications for the educational environment of students, as well as for the maintenance and operating costs that these school systems must continue to bear.

However, if the Baltimore City block grant program leads to the successful accomplishment of capital improvements without harming the State's bond rating or debt affordability, other jurisdictions with extensive facilities needs might be encouraged to adopt the same approach. At that time, it would be necessary to re-examine the implications for the State's bond rating and debt affordability of a substantially enlarged block grant program.

## **2. Impact of a Statutorily Defined Fixed Annual Allocation for Baltimore City Public Schools**

Irrespective of whether the State's allocation is made in the form of a block grant or individual project allocations, the establishment by statute of a mandated annual allocation for any single LEA is of great concern to the other LEAs. If the amount is set too high, it will reduce the ability of the State to respond to capital demands that may change from year to year. In particular, it may affect the ability of the State to preserve an equitable distribution of funds among all of the LEAs in years in which the total available funding is low.

Since FY 2006, the State has met or exceeded the annual target of \$250 million that was established by the General Assembly in the Public School Facilities Act of 2004. This high level of annual funding has allowed the State to provide robust funding for the large and mid-sized school districts, which typically have very extensive requests, and for the small districts, which tend to have one or at most two concurrent major projects that affect a very large proportion of students in the jurisdiction. The practice of the IAC is to recognize that each of the large jurisdictions have capital needs that are very different in kind but very extensive, translating to roughly similar annual allocations of State funding; that the mid-size jurisdictions have combinations of one-off large projects and on-going smaller projects that must be examined on a case-by-case basis; and that the small jurisdictions may have occasional large projects that will require a considerable share of the total State funding at the

time the projects proceed to construction. This equitable approach implies that the IAC must retain great flexibility in responding annually to the submitted needs of the LEAs within the funding allocation that is made available by the Administration and the General Assembly.

Within recent memory, however, the capital budget was set at \$116.5 million in FY 2004 and at \$125.9 million in FY 2005 as a result of severe State fiscal constraints. During those fiscal years, annual funding for even the largest jurisdictions was reduced to well below \$15 million and State approvals of planning, which represent a commitment of future funding for approved projects, were also significantly curtailed. Although the Capital Debt Affordability Committee (CDAC) has predicted the growth of the overall State capital budget from the current \$1.075 billion to \$1.360 billion in fiscal year 2022, if low capital budgets were to recur any time during the proposed block grant period, they would result in a marked disparity in the distribution of State funds: Baltimore City would continue to receive a statutorily defined amount that could only be made possible through reduced allocations to the other large jurisdictions in Maryland. The ability of these jurisdictions to address their extensive capital needs would be severely constrained, and many larger projects in the mid-sized and smaller jurisdictions would not proceed due to the lack of State funding.

### **3. Impact of Baltimore City Program on Design and Construction Services**

The volume of work that may be launched in Baltimore City as a result of using the State and City block grant to repay a large third party bond issuance could have indirect regional effects on the availability of design services and the cost of construction. In general, it is safe to say that if funds are injected too rapidly into the construction market, there could be negative effects on project quality and costs that will affect projects in Baltimore City Public Schools as well as throughout the other jurisdictions in the Washington-Baltimore metropolitan area. Most of these effects can be mitigated through careful project management, a capacity that in turn will depend on the size and qualifications of the management staff that City Schools assembles (see Chapter IV, "Management of the Program," currently under review).

The shift of City Schools' capital program away from small systemic renovation projects toward large renovations, replacements, and possibly new construction projects will represent not only an increase of total construction volume, but also a significant change in the scope of the individual projects that will require design and construction services. For design services, the change will mean that an engineering firm that now contracts with Baltimore City as a prime for systemic renovation improvements related to HVAC, electrical, or structural systems will likely become a consultant to an architectural firm, which will move into the prime role for major projects. There may consequently be fewer opportunities for design firms, particularly smaller firms, to find contracting opportunities with City Schools.

Likewise, trade contractors who work in Baltimore City are likely to see fewer opportunities to contract as primes on smaller projects and an increase of opportunities to contract on larger projects, either as subcontractors to a general contractor (GC) or a construction manager at-risk (CMR), or as prime contractors in a construction management agency (CMA) arrangement. The

proportion between prime contracting and subcontracting opportunities that any individual trade contractor will see will depend on the scope of the 10-Year Plan projects, on the schedule for completion of the projects, and on the delivery method that is chosen for each project.

The recession of recent years is reported to have caused a decrease in capacity within the design professions and the construction industry as firms have been forced to disband due to economic uncertainties. While it is difficult to quantify this effect, anecdotal reports from school districts throughout the state during the last four years have indicated that competition among A/E firms has increased significantly, design fees have been reduced, and firms have either down-sized or ceased to function completely. By report, many trained architects and engineers during this period have been under-employed, employed in areas unrelated to their profession, or simply unemployed. While this situation could make available an ample reserve of talent to carry out the large body of work proposed by Baltimore City, it also can mean that architectural/engineering firms that are experienced in school design may be understaffed at the time that the large volume of work is ready to proceed.

The decrease of capacity within the construction industry is of far greater concern, because it means a reduction of manufacturing plant capacity that may result in significant delays as well as rapid cost increases when work begins to be plentiful. The same may be true for constructors: past periods of very rapid funding expansion led in some cases to sharp declines of quality as inexperienced and under-financed contractors entered the field without adequate scrutiny. Bonding companies, the most common vehicle for securitizing construction, often provided very little relief when contractors failed to perform. Impacts were also experienced in the availability of qualified minority business enterprise firms to meet State and local goals for MBE participation.

All of the factors outlined above will influence the availability of designers and constructors for school projects throughout the metropolitan Washington-Baltimore region, potentially resulting in delays, increased costs, or deficiencies in quality. The impacts are difficult to estimate in advance, since they depend on the actual scope and schedule of projects that will be carried out. In such circumstances, public owners must apply increased scrutiny to every aspect of school construction, from planning through procurement to acceptance of the work.

#### **4. Impact on the Interagency Committee on School Construction**

It is essential that the requirements for IAC involvement with the City Schools 10-Year Plan not reduce the level of service that the IAC provides to the 23 other jurisdictions in Maryland and the Maryland School for the Blind. While it is difficult to fully assess staffing needs pending analysis of the City Schools Management Plan described in Chapter IV, the 10-Year Plan released on November 27, and the forthcoming financial plan, the list of likely actions below indicates that staff enhancements will be needed in order for the IAC to interact smoothly with the Plan while maintaining services that are mandated by law or regulation and that are essential to LEA facility management.

Currently, City Schools' annual Capital Improvement Program (CIP) request typically consists of from one to six major projects, a small number of minor renovation projects (libraries, career tech labs, etc.), and 60 or more systemic renovation projects (boilers, chillers, unit ventilators, roofs, etc.) City Schools has indicated that under the proposed funding plan, the annual request will change to 10 to 15 major projects per year accompanied by funding requests for at most 20 smaller systemic projects. However, the FY 2014 CIP submission received on October 5, 2012, shows that in the period FY 2015 – 2018 City Schools intends to request block grant funding in the total amount of \$145 million and funding for systemic renovation projects in the amount of \$205 million. These presumably will be the projects that Jacobs has identified under the 10-year life cycle category of \$1.011 billion. In FY 2014, City Schools has requested a total of \$88.4 million, of which \$11.2 million is for three major projects and the balance of \$77.2 million is for 60 systemic renovation projects, at an average State funding level of \$1.2 to \$1.3 million per project. If these average figures are correct for future projects, they imply that some 160 to 170 systemic renovation projects might be submitted between FY 2015 and FY 2018, or approximately 30 to 35 per year. Consequently, there will be little reduction in the number of projects that the IAC will be required to review in each annual CIP submission.

If City Schools' capital improvement program under the 10-Year Plan does consist primarily of major projects, some aspects of the IAC's duties may be simplified, particularly the number of applications that must be reviewed each year. However, it is also anticipated that in other respects staff responsibilities will significantly increase:

- **Application Process.** Regular review of project applications may take place outside of the regular CIP schedule, at a time of year when other, non-CIP related duties normally occur, e.g. the updating of regulations and administrative procedures and the research needed for initiatives like public private financing.
- **Project Meetings.** Regular meetings will be held with City Schools, the City, and perhaps the third party bond issuer entity to review project status, project scope, overall financial matters, and other State interests in the 10-Year Plan.
- **Oversight Meetings:** Informed participation will be required at regular meetings of a management oversight committee established to monitor all aspects of the 10-Year Plan.
- **Reporting requirements.** Regular reporting to the General Assembly, the Board of Public Works, and the IAC will be required on issues of program and project status, fiscal accountability, lessons learned, constraints, etc.
- **Fiscal Accountability:** The PSCP will be responsible for monitoring the use of State block grant funds.

- **Minority Business Enterprise:** Actions will include reports, review of goal setting documentation, review of monthly MBE reports submitted with monthly requisitions, and review of overall project MBE records.

To ensure that the IAC can maintain consistent levels of service to all LEAs, it is anticipated that additional staff will be required. Pending submission of the legislation that defines the actual structure and schedule of the City Schools block grant program, and the accompanying information on project scopes and schedules, the following positions may be needed to adequately manage the program:

- **Public School Construction Program:** Review of project applications, financial monitoring, general program oversight, and specific project issues related to procurement and delivery. Anticipated staffing: One senior architect or engineer with a strong background in program management and financial controls, who will be dedicated to every aspect of the 10-Year Plan; one part-time financial officer; and one full administrative support position.
- **Maryland State Department of Education, Facilities Branch:** 10 to 15 additional feasibility studies, educational specifications, and schematic designs will be submitted each year for review. Anticipated staffing: One senior architect, depending on the anticipated schedule for 10-Year Plan submissions. The potential reduction in the number of systemic renovation projects will have no impact on the agency as these projects are not reviewed by MSDE.
- **Maryland Department of Planning, Office of Smart Growth:** There will be a marked increase initially in the review of the backup enrollment data that shapes the 10-Year Plan and the review of the Plan itself. The annual work should be more normal thereafter, since the Plan will be approved at that point, except for necessary annual updates. The need for additional staff should be evaluated during the first year of the program.
- **Department of General Services, Schools Group:** The effect of the City Schools' program will be twofold for DGS. If there is a significant drop in the number of smaller systemic renovation projects, which DGS reviews in-house, current DGS staff will have additional time for review of projects from other LEAs and will receive some relief from the current overload of work. However, DGS would also be responsible for reviewing an additional 10 to 15 major projects each year for the 10 year period. DGS utilizes consultants to accomplish the technical review of major projects, while reviewing general "front-end" procurement documents using in-house staff. The budget to outsource the additional design reviews will be found within the annual CIP (reducing the amount of funding available for capital projects). The additional administrative workload may require an additional staff position or an additional consultant.

The element of the 10-Year Plan that will have the greatest impact on the IAC is the Management Plan that is described in Chapter IV. This plan is currently under review by the staff of the IAC, and an assessment of its impacts on IAC operations and staffing will be provided as soon as possible.

## ENDNOTES

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- <sup>i</sup> See Chapter I for an explanation of these terms.
- <sup>ii</sup> As calculated by City Schools, the generation of 15 times as much upfront funding assumes a 30-year financing term and a 5% interest rate. If the interest rate were to increase to 6%, the 15x multiplier would be reduced to a 13.5x multiplier.
- <sup>iii</sup> In Chapter VII, an annual revenue stream of \$69 million is assumed, the result of recent recalculations by Vantage Point.
- <sup>iv</sup> *Construction cost escalation* is not the same as *inflation*, as measured by instruments like the Consumer Price Index (CPI). Construction cost escalation is unique to the construction industry and while it is affected by the price of commodities in the consumer sector, especially gasoline and other petroleum products, it also depends on a congeries of other factors: concurrent building activity in the region, the cost of interest, the capacity and backlog of plants that produce equipment and materials, the extent to which a specific project depends on labor vs. capital inputs, and even overseas events that can affect the availability and hence costs of specific building materials.
- <sup>v</sup> A 4% annual increase in construction costs is consistent with direction given by the Office of Capital Budgeting in the Department of Budget and Management for projects in the Governor's Capital Improvement Plan. This figure was established by the Department of General Services for State projects that bid in FY 2013. Other sources predict a higher rate of construction escalation: Gilbane Corporation predicts 4% in 2012, 5% in 2013, and 6% in 2014 (Edward R. Zarenski, *Market Conditions in Construction*, May 2012). While actual construction cost escalation depends on a large number of factors, 4% per year is likely to be a conservative figure. While the 4% construction cost escalation factor is reasonable in today's market and is supported by a number of sources, this is a notoriously difficult item to predict. From 2004 to 2008 construction costs escalated at annual rates of from 12% to 20%, depending on the scope of work and the timing of the procurements; from 2008 to the present, in spite of numerous industry predictions of impending increases, construction costs for school construction have remained fairly level.
- <sup>vi</sup> City Schools has used an annual figure of \$286 million in its development of a management program, see Chapter IV.
- <sup>vii</sup> *Information for You* from Greenville County Schools, BEST School Construction Program.
- <sup>viii</sup> Brian Foret, AIA, powerpoint presentation "Alternative Funding and Financing of Public School Facilities," September 19, 2011; available on the PSCP website at [www.pscp.state.md.us](http://www.pscp.state.md.us).
- <sup>ix</sup> Earthman, Glen I. and ACLU of Maryland, "Prioritization of 31 Criteria for School Building Adequacy," Virginia Polytechnic Institute and State University, January 2004.
- <sup>x</sup> Lawrence Berkeley National Laboratory, "Impacts of Building Ventilation on Health and Performance, Indoor Air Quality Scientific Finding Resource Bank (<http://www.iaqscience.lbl.gov/vent-summary.html>)
- <sup>xi</sup> Hescong Mahone Group, "Daylighting in Schools," San Francisco, CA 1999.
- <sup>xii</sup> Figueiro, M. G. and M. S. Rea, "Lack of short-wavelength light during the school day delays dim light melatonin onset (DKMO) in middle school students," *NeuroEndocrinology Letters*, 2010.
- <sup>xiii</sup> Maryland Department of Planning Models and Guidelines, Volume 27, "Smart Growth, Community Planning and Public School Construction", July 2008; Vincent, Jeffrey M. *etal*, "Families and Transit-Oriented Development: Creating Complete Communities for All", Center for Cities & Schools, University of California at Berkeley, June 2012

## CHAPTER IV: MANAGEMENT OF THE PROGRAM

### JRC Topic 4: Review best management practices for the large volume of construction projects that would likely result from such a block grant program

The importance of a good management plan in the implementation of a broad capital program cannot be emphasized enough. Good management has multiple components: adequate and appropriate staffing, well-established protocols for communication and decision-making, procedures for day-to-day project management, and thorough accountability measures. A well-conceived management plan will ensure that the projects that will be funded in the 10-Year Plan will, in the end, be the right schools in the right locations; will be designed to properly support the educational mission of teachers and students; will be built according to specification and good building practice; and will not present a burden for the future staff who must maintain and operate the facilities.

City Schools proposes the following management plan for the 10-Year Plan. This management plan, which was submitted to the IAC on November 14, 2012 and is currently under review by the staff of the IAC, is presented in this report without amendment or comment. Two organizational charts are provided at the end of this chapter, one showing the current staffing of the City Schools Department of Facilities Design and Construction, the other showing the proposed staffing of the Department as well as of the Building Authority. The IAC's assessment of the management plan will be provided as soon as possible following discussion with City Schools.

In addition to the management plan, the financial plan referenced at several points in the following is a crucial component of the overall business plan. It is the understanding of the IAC that the financial plan will be provided in January or February 2013.

#### **MANAGEMENT PLAN FOR BALTIMORE CITY 10-YEAR PLAN**

***As submitted by Baltimore City Public Schools on November 14, 2012.***

#### **BACKGROUND**

##### ***Magnitude of the Work:***

*The work to be accomplished under City Schools' 10 year Plan is currently estimated at \$2.4 billion plus FFE (fixtures, furnishings and equipment) and construction escalation costs, to be expended at an average annual rate of \$286 million per year for the 10-year construction period. This will result in 10 to 15 major construction projects per year for 10 years and, when complete, will result in either new or totally renovated school facilities for all students attending Baltimore City public schools.*

*In order to centralize the financing and monitoring of this significant undertaking separate and independent of the financial activities of City Schools, there is proposed the creation of the*

*Baltimore City Public Schools Building Authority (the "Authority"). The Authority will receive the block grants from the State and the City. The Authority will coordinate the financing of the portion of the construction that is funded by block grants. The Authority may issue directly or through a conduit issuer bonds on a periodic basis to fund a portion of the construction program as set forth in the 10-year Plan adopted by the Baltimore City Public Schools Board of Commissioners. The Authority will manage the expenditure of the block grants and any bond proceeds to assure that such funds are properly spent to implement the 10-year Plan, the Authority will also monitor the efforts of the City Schools and the contractors to assure that construction is undertaken and finished in accordance with the IAC policies and procedures.*

*The Authority will provide quarterly reports to the State, City and City Schools on the expenditure of the block funds, any bond proceeds, and on the progress of the construction within the time frames established by the 10-year Plan. It will provide an annual financial audit performed by an independent public accounting firm and an annual construction audit performed by an independent private company with expertise in such audits. The Authority will approve all construction contracts funded with the block grants and proceeds from bonds secured by the block grants. The Authority will work closely with the Department of Facilities Design and Construction of the City Schools and the IAC to assure that the contracts are performed properly in accordance with IAC regulations and policies.*

#### **THE REQUIREMENTS OF A WELL MANAGED PROGRAM**

*In 1999, the 21st Century School Fund Best Practices Report (Best Practices Report) looked at seven school systems nationwide that implemented large capital improvement programs and noted some of the most effective models for managing for large scale programs.<sup>i</sup> The recommendations were broken into six basic processes: 1) Information gathering, 2) Planning, 3) Needs-based decision-making, 4) Funding, 5) Management, and 6) Oversight. Within each of these processes, the Best Practices Report identified specific criteria that the LEAs had implemented which led to their efficiency and successful completion. The Jacobs Report in combination with the City Schools 10-Year Plan and the Management Plan discussed in this section incorporate many of the Best Practices Report criteria.*

1. **Information.** *Accurate information about facilities conditions, capacity, current and projected usage, and current budget and expenses were cited in the Best Practices Report as essential to developing a needs-based list of priorities to be addressed by the capital improvement program. They also emphasized the ability to update this information regularly so that costs could be managed effectively. The Jacobs study has provided Baltimore City Schools with this vital information on which it has built its 10-Year Plan.*
2. **Planning.** *The Best Practices Report noted that sound planning, including long-term planning, capital improvement planning and maintenance planning during the implementation of the program, were essential for the projects to be completed on-time*

*and on-budget. The report suggested that a comprehensive plan needed to cover at least two capital budget cycles, usually of five or six years each, resulting in a long-range plan for a period of 10 to 12 years.*

*After engaging in community discussions throughout the summer, City Schools has formulated a comprehensive 10 Year Plan that incorporates ideas and requirements expressed by principals, teachers, security personnel, food-service staff, maintenance personnel, students, and others who will use the new, modernized, or improved facilities. The Best Practices Report indicates that public involvement in planning helps to build trust among the public, the boards of education, and elected leaders, while also minimizing project interruptions and facilitating funding decisions.*

- 3. Needs-Based Decision Making.** *The Best Practices Report identifies the need for a clear process for needs-based decision making that clearly identifies roles for the school system, elected leaders, the State and the public. The Report found that in the best examples of capital programs, the State exercised its role through existing laws, policies and regulations. Development of the long-range educational facilities master plan, the capital improvement plan, and the capital budget were the responsibility of the school administration, with consideration given to benefits the community would receive from the building program, such as use of the school buildings for community-based programs. Approval of the plans rested with the elected or appointed governing bodies, with input from the public. The IAC staff is reviewing the City Schools Management Plan to ensure that all existing Maryland requirements for design, construction, maintenance and procurement are addressed in the 10-Year Plan.*
- 4. Funding.** *The 10-Year Plan proposed by Baltimore City Schools and discussed in the Introduction and Chapter III identifies an alternative financing model to provide sufficient and stable funding for Phase I of the 10-Year Plan, to ensure the program's success. The Best Practices Report suggest that adequate and secure funding needs to be identified at the start of the program and that capital funds "should be efficiently applied so that the majority of the improvements will have a life span at least equal to the life of the bond." Maryland's Public School Construction Program allows State funds to be used only for improvements that have an anticipated life that averages 15 years, the term of its general obligation bonds. Likewise the City general obligation bond program allows bond proceeds to be used for improvements generally with an anticipated life that averages 20 years, the term of the City's general obligation bonds.*
- 5. Management.** *Skilled and effective project management has been cited as a critical element in the program. Among the best practices in project management include a structure in which there is an overall program/project manager, who is responsible for all aspects of the project--programming, total project budget, overall project schedule and procurement for all services required. In this structure, the program/project*

*manager reports to the chief of operations of the school system and provides informational reports directly to the Authority's Project Directors. Reporting to this layer of management would be construction managers who are selected and managed by the project manager based on qualifications, but with the school system negotiating the fees and the Authority approving the fee arrangements. The construction management approach, whether under an agency or an at-risk format, allows the public owner to gain full disclosure of all costs and to have a voice in the selection of trade contractors. Baltimore City Schools' program management proposal, discussed later in this chapter, suggests a management structure that reflects these best practices.*

6. **Oversight.** *The IAC has paid particular concern to oversight and monitoring throughout this report. Best practices show that accountability and transparency measures are paramount to a successful capital improvement program. Regular reporting to the boards of education, the funding entities, and the public should be standard practice, and routine documentation of the scope, progress, and cost of projects must be readily available upon request. Additionally, projects should be subject to annual external audits of capital expenditures or periodic management reviews by outside consultants. In addition, engineering audits must be a regular part of construction programs<sup>ii</sup>. The present IAC process meets all of these criteria; it is proposed that Baltimore City Schools' 10-Year Plan continue to meet the current IAC standards and that binding instruments be in place between the affected entities in order to ensure adherence to these construction and financial management standards.*

## **OVERALL MANAGEMENT STRUCTURE**

### ***Impact of the Work on City Schools Operations Department***

*While it is anticipated that the change of the capital improvement program from repair and renovation to primarily major new construction projects may simplify aspects of the Department's duties, it is also anticipated that the other aspects of the program will significantly increase staff responsibilities. The current workload of the Department of Facilities Design and Construction averages over 100 projects annually at \$100 million per year for the last three years. The considerable improvement in the performance of the Department of Facilities Design and Construction over the past four years in administering the design and construction program has been noted by the Interagency Committee on School Construction (IAC) and others, including the Board of School Commissioners.*

*Nevertheless, it has also been repeatedly noted that City Schools does not have sufficient qualified staff to carry out its facility management program under the 10-year Plan, which would result in excessive demands placed on Department staff. This is an area of great concern considering the increased magnitude of the 10-Year Plan. The Department currently has a staff of 14 full time employees (FTEs) as follows:*

- *The Director and one Secretary*
- *One Senior Architect*
- *Two Architects (one registered and one graduate)*
- *Three Engineers (two mechanical and one structural)*
- *Four Construction Project Managers (including one vacancy to be filled)*
- *Two Inspectors (one electrical and one mechanical/plumbing)*

*The change from a large number of small projects to a relatively small number of major projects will simplify some aspects of the department's work, particularly in terms of financial paperwork, scheduling, and the number of projects assigned to each staff member. It is also anticipated that the other aspects of the change will increase staff responsibilities. As a point of comparison, Montgomery County Public Schools (MCPS), which has carried out approximately \$250 million of construction annually for several years, has a design and construction staff of approximately 45 FTEs. However, MCPS has not used a program manager approach of the type proposed by City Schools and described in this Chapter.*

***Proposed Staffing***

*Under the proposed management plan, which utilizes a consultant program management firm and multiple construction management firms that will assure the necessary expertise and staffing to manage the construction, there will be a need for both more staff to properly monitor the design and construction and to protect the interests of the Board of School Commissioners, of the State, of the City and the Authority. It is expected that the new positions will be financed out of the funding used and approved by the Authority for the construction of the facilities under the 10-year Plan. The Authority will work closely with the Department of Facilities Design and Construction to assure that these positions are properly funded and sufficient to assure proper monitoring of compliance with the IAC regulations and procedures that are designed to require high quality construction. While the Authority will be accountable for the funding of these positions, the individuals will work under the supervision of the Facilities Design and Construction staff. (Please see the attached organizational chart for a visual presentation of the proposed changes in relation to the current organizational structure.) Approximately 20 FTEs would be funded from the construction funds to work in conjunction with the Department of Facilities Design and Construction, bringing the total combined number of FTEs to 34 in the Department to assure proper management, monitoring, and implementation of the day to day construction activities. An additional 5 FTE's would work directly for the Authority, independently from City Schools as indicated on the attached organizational chart.*

*The additional staff, funded through the Authority as part of the capital expenses during construction, will allow the close monitoring of all aspects of the construction while assuring that the policies and procedures of the IAC are adhered to throughout the construction period.*

- *Assistant (or Deputy) Director of Facilities Design and Construction (1) - The position will provide additional management to monitor the A/E teams, the program management firm and the construction management firms, as well as other projects not part of the 10 year facilities plan. The individual in this position will also monitor and supervise the expanded staff of the Department.*
- *Educational Facilities Planners (2) – one senior and one junior. Tasks will include coordination with senior academic planners, the local school community Facilities Design and Construction staff, and with the assigned project architects; development of prototype educational specifications and modifications for individual school projects; educating local school representatives on the design and construction process; ensuring a smooth transition from planning to construction; coordinating annual reviews and updates to the 10 year plan; and conducting projects from inception through schematic design approval.*
- *Budget Specialist. This position will insure proper review of the financial and budget data for the overall program and the individual project financial and budget reports produced by the construction management firms, and will assist in the review of project requisitions.*
- *Procurement Specialist. This position will address the volume of competitive sealed bid projects and its associated paperwork, the procurement chores associated with the program management, construction management and A/E contracts, and the general increase in procurement related tasks associated with the work.*
- *Senior Construction Manager. This position will oversee the increased project manager staff and inspector staff in the same manner in which the Senior Architect oversees the Design*
- *Engineers (three total): one (1) Mechanical, one (1) Civil and one (1) Electrical. These positions will maintain the quality of the A/E design work through extensive internal review of all projects prior to releasing them for bidding. Design reviews will be carried out in conjunction with the construction management firms and the IAC at the design development, 65% and 99% stages of design for each project.*

- Project Managers (three total): These positions will work with City Schools Department staff and will be assigned to each construction management firm in order to provide proper internal monitoring of activities.
- Construction Inspectors (eight total): one (1) electrical, two (2) mechanical/plumbing, two (2) roof, one (1) site/civil, one (1) structural, one (1) general construction. These positions will provide oversight of what are perhaps the most important areas requiring close internal monitoring, the quality of construction and the adherence of the builders to approved plans and specifications. The eight inspectors will each have both general inspection abilities and a specialty area.

## **Management Structure**

### **Overview**

*The Interagency Committee on School Construction (IAC) as a management body, and the Public School Construction Program (PSCP) as a funding program, were formed by the Board of Public Works in 1971 to ensure effective use of State dollars in school construction projects, and have a proven track record over many decades. These structures have the expertise and authority to review and approve projects (and in this case, comment on an overall plan), and intervene when necessary to assure quality, accountability, and compliance with various State standards and policies such as design review, contract approval and minority business enterprise participation.*

*The relationship between City Schools and the PSCP and IAC is well established and has been developed over many years of collaborative work. Given this level of collaboration, preserving the role of the Department working with the IAC to assure the proper performance of the outside contractors and consultants will enhance accountability and monitoring capabilities without creating unnecessary layers of bureaucracy and duplicative oversight, undermining the current system and adding to costs. However, implementing a large-scale school construction program in Baltimore will require some changes at both the State and City Schools levels. To that end, the State's PSCP and IAC will work with City Schools and the Authority to make necessary changes in procedures to maximize effectiveness and efficiency in implementing large projects while retaining the ability to monitor critical State and local interests in the projects. The implementation of the day to day activities will be set forth in a memorandum of understanding among the parties to assure consistency throughout the construction period.*

*City Schools will adhere to any and all regulatory requirements that are applicable to the procurement, design and construction of the overall body of the work. These consist of State regulations found in COMAR 23.03.01 through 23.03.05; Article 5 of the Baltimore City Code, and Section DJA-RA of the Administrative Regulations of the Baltimore City Public Schools. Financial regulatory requirements are addressed in the financial appendix.*

*The Authority will employ an executive director, fiscal specialist, administrative coordinator, and two project directors. The Authority acting through its staff will participate in the regular*

*progress meetings and receive the reports from the IAC, the Department, the program management firm, and the construction management firms assuring proper oversight and of the expenditure of construction funds obtained through the Authority's use of the block grants. While not having day to day supervisory responsibilities it is expected that the Authority's Project Directors will participate in all status and progress meetings, receive all reports from the program management firm and have full access to all of the documents, records and books related to the construction expenditures and activities.*

*In terms of implementation of the school construction program, the role of the Authority will be to facilitate financing, to approve City School's selection of the program management firm and to enter into a contract with the firm. The Authority will monitor receipt of the block grants and any bond proceeds and the expenditure of such funds. The Authority will monitor the progress of the construction, but the Authority will not participate in the drafting or creating of the 10 year Plan that will contain the priorities of projects and academic adequacies of the construction designs.*

*Please see the attached organizational chart and the paragraphs below to further understand the structure proposed for the overall management team.*

#### **The Authority**

*The Authority will be created by State law for the purpose of receiving the block grants from the State and the City. The Authority will coordinate the financing of the portion of the construction that is funded by block grants. The Authority may issue directly or through a conduit issuer bonds on a periodic basis to fund a portion of the construction program as set forth in the 10-year Plan adopted by the Commissioners of the City Schools. The Authority will authorize the expenditure of the block grants and any bond proceeds to assure that such funds are properly spent to implement the 10-year Plan, the Authority will also monitor the efforts of the City Schools and the contractors to assure that construction is undertaken and finished in accordance with the IAC policies and procedures.*

*In order to ensure that all parties are fairly represented in critical facility decisions, the Authority will have nine members. Two will be appointed by the Governor; one of whom must be a member of the Interagency Committee on School Construction. Other members will consist of two appointed by the Mayor of Baltimore City, one of whom must have expertise in finance and the Chief Executive Officer of the Baltimore City Board of School Commissioners or his designee. The other four members are to be appointed by the Baltimore City Board of School Commissioners, two of whom must have expertise in the fields of architecture, or engineering, or financier, banking, or construction. The members will elect a chairperson from among its members. The members may only be removed for cause to assure their independence.*

### **Proposed Management Structure**

*The proposed management structure is very simple yet contains multiple levels of controls of all aspects of the program. The structure is shown on the attached organizational chart. The report section below, entitled **Management Tasks**, presents detailed information on specific management tasks and on the interaction between these tasks. In addition, a detailed explanation of the need for additional staff to work with the City Schools during the implementation of the 10 year plan and staff for the Authority is presented above in the paragraph entitled *Impact of the Work on City Schools Operations Department*.*

*The major elements of the structure are as follows:*

- *The Baltimore City Board of School Commissioners will establish the academic objectives and building priorities to meet those objectives in the 10-Year Plan*
- *The Authority will provide a means for the City Schools to implement a financing plan to fund the 10-Year Plan and will provide financial controls and auditing as well as monitoring of the construction financed through the Authority to implement the 10-Year Plan.*
- *The Department of Facilities Design and Construction will work with oversight by the Authority in the day to day implementation of the 10-Year Plan coordinating interactions with all of the appropriate State agencies and private contractors.*
- *The Authority staff will monitor the activities of the Department and outside contractors, and consultants to assure proper use of the block grants and the financing provided directly by the Authority or through a conduit issuer.*
- *A program management firm will be responsible for the monitoring the original 10 year plan scheduling, budgeting and cost control of the overall program. The firm will work in conjunction with the Construction Management firms which will be responsible for scheduling, budgeting and cost control of the individual projects.*
- *The Construction Management firms will be responsible for supervision of the construction, scheduling, budgeting and cost control of the individual projects in both the design and construction phases. These firms will work in conjunction with the Program Management firm and the Architect/Engineering teams, as well as the contractors performing the construction.*
- *The Architect/Engineering teams will participate in the design and construction administration process, from schematic design through bidding, as well as in the construction phase through post warranty inspections.*

- *The program management firm, construction management firms, and Architect/Engineering firms will be selected from prequalified lists of firms that are established following the issuance of RFPs and the completion of a competitive process conducted by City Schools in compliance with City Schools procurement regulations. Once the firms are selected they will enter into contracts with the Authority. The contracts will contain preconditions for payments to the firms including but not limited to the acceptance of the work performed under the contracts by City Schools and the IAC.*

### **Management Tasks**

#### **Developing the Scope, Schedule and Costs**

*The Introduction to this report provides an overview of the Jacobs Report and the process for developing the 10-Year Plan, including a schedule for approval by the Board of School Commissioners. Upon approval of the 10 year plan by the Commissioners, the initial schedule for the overall 10 year program will be established by the Program Management firm in conjunction with the Office of the Chief Operating Officer and the Authority consistent with the initial cost estimate prepared by Jacobs Project Management.*

*Lack of attention to schedule and cost overruns has caused problems for several school systems that have pursued large scale facility improvement programs. The New Jersey Schools Construction Corporation, described in Chapter II, is a good example of this. The process we propose has multiple built-in controls. It should be noted that the use of outside design consultants, Program Management firms and Construction Management firms does not remove responsibility from the Board of School Commissioners to ensure that the program as a whole, as well as individual projects, are well managed by City Schools staff. The Authority shall not provide funding for any construction until The Authority receives a written notice from City Schools which specifically states that the contract work to be performed is in furtherance of the 10-year Plan.*

*Under the oversight of City Schools staff, schedule and cost control will be reviewed monthly for each individual project by the A/E team, the Construction Management firm ,the Program Management firm, and the Authority's Project Directors. The Program Management firm will produce a monthly report covering all projects in progress. All of these monthly reports will be reviewed by staff of the Office of the Chief Operating Officer, and the Authority's Project Directors.*

*As the implementation of the 10 year plan proceeds, the Program Management firm will be responsible for the 10 year scheduling, budgeting and cost control of the overall program. Under the oversight of City Schools staff, they will work in conjunction with the Construction Management firms that will be responsible for scheduling, budgeting and cost control of the individual projects. The Construction Management firms will prepare monthly reports in the*

*design and construction phases covering scheduling, budgeting and cost control for each project for which they are responsible, and will submit them to the Program Management group, the Authority, and the Office of the Chief Operating Officer. The Program Management group will review these individual reports and will prepare a comprehensive report covering the work for the overall 10 year plan and submit it to the Office of the Chief Operating Officer and the Authority's Project Directors.*

### ***Project Planning and Design***

*Based on information contained in the Jacobs Report and several other data sets as described in the introduction, City Schools has developed the 10-Year Plan for the school district's building inventory. The recommendations contained in the 10-year Plan include building closures, school consolidations, replacement schools, new schools, building renovations/modernizations and building additions where needed to accommodate enrollment. Initial prioritization has been completed and a listing of projects for years one through ten has been created; the out-year listings are subject to periodic review and modification in order to adjust to demographic changes, new educational programs, and mandates from the federal, state, or local level. Final Board approval of the plan is expected at the January 8, 2013 Board meeting. Changes in the 10-Year Plan made after the January approval will be submitted to the Board for approval on an annual basis or as required.*

### ***Educational Specifications***

*The educational specifications, which will be developed in collaboration with the Chief Academic Officer of City Schools and the IAC, will include not only the types and sizes of educational spaces and their relative adjacencies within the school and on the site, but also the requirements of the maintenance, operational and other support service personnel who will be responsible for the facility for many years*

### ***Feasibility Studies***

*For each proposed project, City Schools will select an architectural/engineering (A/E) firm from the current list of on-call firms that have been approved by the Board and the Authority for assignments where fees are under \$200K. These consultants will perform a feasibility study for each project, based on the approved educational specification, which will determine the scope and estimated cost of the work.*

*Each year, the projects proposed for construction will be submitted to the PSCP in a manner similar to the annual CIP submission. It is anticipated that the submission will resemble the annual CIP submission, including but not limited to the standard IAC/PSCP forms (Forms 102.1 and 102.2 for each current project, Form 102.3 for future projects, and Form 102.4 as a summary). The submission would be "off cycle" from the annual CIP, meaning that it would be submitted at a time when the staff of the IAC likely would not be in process of evaluating the CIP submissions of the 23 other LEAs that they must review during the October to May time frame. This does not mean, however, that this interim period is without scheduled activity: it is used by*

*the IAC staff to accomplish a number of other tasks that cannot be carried out during the CIP process from October to May. The impacts on the IAC staffing and process are outlined in Chapter III.*

*Design and Construction Administration Services*

*The Authority will work with City Schools to issue a new RFP to create a list of prequalified A/E teams to perform design and construction administration for the projects that will be executed under block grant funding and will have anticipated A/E team fees over \$200K. The intent of the RFP will be to assemble a group of approximately 20 A/E teams. From this list, three to four teams will be asked to submit project specific qualifications and fees for the design and construction administration of each specific project, with the award being made on the basis of both the team's specific project qualifications and the cost. The teams invited to provide specific project proposals will follow the qualification ratings determined under the original RFP: teams will be invited to submit proposals in the order of the original selection list and the first group invited will not be invited to participate again until all other teams have had an opportunity to participate in the process, unless a particular firm or firms demonstrates specialized qualifications for a specific project.*

*All A/E design and construction administration contracts will be with the Authority. The contracts will contain preconditions for payments to the firms including but not limited to the acceptance of the work performed under the contracts by City Schools and the IAC to allow for maximum oversight. Each A/E team selected for a specific project will be assigned to a construction management firm that will participate in the design and construction administration process, from schematic design through bidding and in the construction phase through post warranty inspections. The role of the construction management firm in the design process will be to assist the A/E team in design oversight, value engineering, schedule determination, constructability review, and cost estimating.*

*The RFP for A/E services will be reissued every three years to allow for the addition of new A/E firms and the deletion of firms not providing quality services.*

*Preference will be given in varying degrees to firms with production offices located within Baltimore City, the State of Maryland and directly adjacent States that have direct experience with the regulations and policies of the IAC and that are experienced in the design of school facilities that fall under the purview of the IAC.*

*The standard PSCP process for design review and approval will be strictly adhered to, with an educational specification and a schematic design submission to the Facilities Branch of the Maryland State Department of Education and a design development and construction document submission for review by the Department of General Services (DGS). Bidding for each project will not proceed until PSCP approval has been obtained.*

## **Construction Services: Procurement and Tasks**

### *General*

*It is anticipated that no significant changes will need to be made to the existing City Schools procurement regulations adopted by the Board of School Commissioners. Some adjustments in procurement practices will be necessary to streamline the bidding, Board approval and contract execution process.*

*Selection of the program management firm, the construction management firms and the A/E firms will be a quality-and-cost based selection with a weight of 60% for quality and 40% for cost.*

*It is anticipated that the great majority of the construction projects will be procured by competitive sealed bid using a general contractor (GC) or a multiple-prime contractor format in a Construction Management Agency (CMA) arrangement. It is possible that selected larger projects or projects requiring an accelerated schedule will be delivered through a Construction Management at Risk (CMR) method with a negotiated Guaranteed Maximum Price (GMP). In these cases, IAC requirements for CMR procurement will be followed in accordance with COMAR 23.03.01.01(B)(9) and COMAR 23.03.04, et seq. It is not anticipated that Job Order Contracting (JOC) will be utilized for the block grant funded projects.*

### *Program Management Services*

*City Schools will issue a new RFP approved by the Authority for the selection of a Program Management (PM) firm. The firm will be responsible for the overall management of the 10-Year Plan in conjunction with the Office of the Chief Operating Officer. The Program Management contract will be with the Authority. The contracts will contain preconditions for payments to the firms including but not limited to the acceptance of the work performed under the contracts by City Schools and the IAC to allow for maximum oversight.*

*The selected program management firm will designate its staff assigned to the project as the "program management group" for the implementation of City Schools' 10-Year facilities plan.*

### *Construction Administration and Management Services*

*City Schools will issue a new RFP approved by the Authority to create a list of prequalified firms to perform CM duties for projects executed under block grant funding and having anticipated CM fees over \$200K. The intent of the RFP will be to have a group of at least five CM firms available for block grant financed projects. It is anticipated that only three firms will be needed for the first year of the work with the need rising to five firms when the program reaches full development during the second year. Alternatively, all of the firms could be selected for a reduced number of first-year projects to allow them to grow into the full program. As the program proceeds into the middle years, City Schools will evaluate the need for additional construction management firms.*

*Preference will be given in varying degrees to CM firms with production offices located within Baltimore City, the State of Maryland and directly adjacent States that have direct experience with the regulations and policies of the IAC and that are experienced in the management of school facilities falling under the purview of the IAC. The RFP for construction management services will be reissued at least every three years to allow for the addition of new construction management firms and the deletion of firms not providing quality services.*

*All construction management (CM) contracts will be with the Authority. The contracts will contain preconditions for payments to the firms including but not limited to the acceptance of the work performed under the contracts by City Schools and the IAC. to allow for maximum oversight. Construction management firms will be able to perform under construction management agency (CMA) or construction management at-risk (CMR) scenarios; however in the bulk of their project assignments they will perform as a CMA, or will have oversight over a general contractor (GC). Since CMR could be used for projects financed under the proposed block grants, the RFP and the Construction Management firms' contracts must be reviewed and approved by the IAC to insure compliance with the notification and competitive bid requirements that apply to CMR work, where the construction management firm would be providing and installing materials and equipment in addition to normal management services. If reimbursement for CMA construction-phase fees is sought, the procurement of the CMA must also follow the regulations of the IAC.*

*The Construction Management firms will work in conjunction with the Program Management group and will be responsible for monitoring all aspects of the design and construction, including scheduling, cost estimating, cost control and quality control, and for preparing detailed monthly progress reports and financial reports for each individual project assigned to them. The reports will be submitted to the program management group, the Authority and the Office of the Chief Operating Officer. It is anticipated that each CM firm will oversee up to six individual projects and A/E teams. They will participate in the design process from schematic design through bidding, and in the construction phase from contract award through post warranty inspections and final close out.*

*To ensure the delivery of quality school facilities, all the normal protections of the owner of a construction project will be in place: the right to reject bidders who are unresponsive, non-responsible, or otherwise unfit to carry out the work; the right to request recovery of project schedule in case of contractor-caused delay or to request acceleration in case of owner-caused delay; the right to review the work at any point; normal default proceedings in case of faulty work or other types of non-performance; holding of retainage to ensure completion of the work; and other provisions that are normal to public works. In addition, all projects will receive building commissioning.*

**Move-In**

*The move in for the projects will be planned and directed by the Office of the Chief Operating Officer. The logistical tasks of specifying and purchasing furniture and equipment, arranging for deliveries and installation, ensuring the safety and security of personnel and equipment, testing IT equipment, and establishing training schedules for new principals and staff, among other move-in tasks, will require at least one full time person to outfit 10 -15 new schools. It is strongly recommended that the Chief Operating Officer discuss the experience of other large school systems like Montgomery that are involved in move-in operations at the start of every school year, or systems like Prince George's that performed all of the above with a dedicated, high level move-in officer for the opening of nine new schools in 2002.*

**Project Closeout and Post Construction Evaluation Period**

*The post-construction evaluation period for each project begins after the completion of final inspections and systems commissioning, substantial completion, and correction of all punch list items, followed by sign-off on the contract work by the A/E team, the construction manager, the program management group, the commissioning agent and City Schools staff. Following sign-off, the building constructor (the GC or the trade contractors) will receive final payment less retainage, but the responsibilities of the CM and the PM will continue.*

*The post-construction evaluation period essentially matches the two-year project warranty period that will be required for all projects (longer warranties will be required for specific building systems, e.g. roofs). The design, construction, commissioning and management team will remain active on the project throughout this period. Warranty work will be facilitated by the construction management firm and City Schools staff and be monitored by the Authority's Project Directors. The first phase of the period will consist of finalizing construction closeout materials for each project, including but not limited to the following.*

- *Preparation of the standard IAC close-out package, including all change order data, for submission to the IAC.*
- *Preparation of the final MBE utilization report.*
- *Distribution of the final approved Operation and Maintenance Manuals to the schools, City Schools' Department of Maintenance and Operations and Department of Facilities Design and Construction, and the program management group.*
- *Finalization of the 10 year operational and preventative maintenance plan developed by the commissioning agent for City Schools' Department of Maintenance and Operations.*

*A report covering all aspects of the project design, construction, commissioning and management will be produced by the Construction Manager for each specific project within*

*three months of the sign-off for each project. The report will include complete financial and schedule data for the project, successes and failures in all aspects of the project and a listing of lessons learned to help facilitate future projects.*

*In addition, the Program Manager will be required to conduct a post-occupancy evaluation of each building within the 10-Year Plan as well as of the Plan as a whole during each summer following building occupancies. This evaluation should address at a minimum:*

- Overall performance of the PM, CM, A/E, constructor, and City Schools staff.*
- Move-in operations*
- Design issues*
- IT issues*

*During the first year following occupancy, the heating season functional performance testing will be completed by the commissioning agent. It is anticipated that it will be possible to conduct the cooling season testing for some projects as construction closes out and that the heating season testing will be done in December of the first year of building operation. Cooling season testing for projects that open late in the cooling season will be conducted the following summer.*

*One year after the sign-off, the construction management firm and City Schools inspection personnel will perform a general building inspection to observe the construction and building systems and note any items requiring correction under the building warranty, specific system warranties, or otherwise.*

*The end of the general building warranty period will occur two years after the sign-off. The Construction Management firm, a representative of the Program Manager, the A/E team, the commissioning agent, the Authority and City Schools inspection personnel will perform a detailed building inspection to observe the construction and building systems and note any items requiring correction under the building warranty, specific system warranties, or otherwise.*

*Following the resolution of all issues that arise as a result of the warranty inspection, the project will be closed out and the remaining retainage paid to the constructor (GC, trade contractors under CMA). In addition, the report noted above covering all aspects of the project will be amended to include warranty period issues. A number of individual building system warranties will remain in effect for various terms (e.g. roofing).*

### **Financial Management**

*For the overall financial management plan, please see the appendix for the financial plan prepared by the office of the Chief Financial Officer.*

### **Minority Business Enterprise (MBE) Participation**

*For all construction contracts, City Schools and the Authority will continue to use the existing State MBE goal setting procedure. MBE participation goals and subgoals will be set on a project-by-project basis and will be administrated by the MBE section of the Office of the Chief Legal Officer. Goal packets submitted as part of contractor bids will be reviewed by City Schools' staff and the package of the successful bidder will be sent to the IAC (and GOMA, as applicable) for further review as a condition of contract approval. While procedurally this represents no change from the current procedure, there is a very significant change to the import of IAC approval of contract, as discussed in the Introduction.*

*Contractors will be required to submit MBE participation reports with each monthly requisition. The reports will be reviewed by City Schools staff and be made available to the Authority. Requisition and report copies will be sent to the IAC for their records. This differs from the current procedure in that the Authority or the bond trustee will be paying the requisitions instead of the State paying the contractor from available State funds, but the paperwork submitted to the State on a monthly basis would be essentially identical. Final MBE participation reports will be submitted to PSCP for all projects as a component of the closeout documentation.*

*For all design, commissioning, construction management and program management contracts issued for block grant projects, the MBE participation goal-setting procedures established by the IAC for State-funded public school construction projects will be followed.*

### **Reporting**

*City Schools' management plan contains multiple levels of reporting requirements. Some of these reports are sent to the IAC in accordance with their procedural requirements, however any report may be sent to the IAC should they so wish. Such reports may include items that will be requested by the General Assembly or the Board of Public Works to ensure that State funds are being well managed.*

### **Accountability Issues**

#### **A/E Design Quality**

*A decline in the quality of A/E design efforts appears to have occurred over the past 10 years, evidently more on the engineering side than the architectural side. The decline in quality seems to be concentrated in the mechanical, plumbing and electrical fields. The causes of this decline are not well understood.*

*Maintaining the quality of the A/E design work will require extensive internal review of all projects prior to releasing them for bidding; all of the new positions described above will be*

*involved in this critical activity, which affects not only the cost and efficiency of construction but also the long-term utility of the finished building. Design reviews will be done by City Schools staff in conjunction with the construction management firms at the design development, 65% and 99% stage of design for each project. In addition to the internal and CM reviews, the projects will also be reviewed by the commissioning agent responsible for MEP building systems commissioning. Mandatory review of schematic designs, design development documents, and construction documents by the IAC staff will provide another level of quality control.*

### **Construction Quality**

*Perhaps the most important area requiring close internal monitoring is construction quality and adherence to plans and specifications. The most efficient method to do this is by utilizing experienced and highly competent construction inspectors. To accomplish this, City Schools has proposed that eight inspectors be added to the current staff of two, and all of these individuals will have both general inspection abilities and a specialty area. The specialty areas to be sought and number of inspectors are electrical (1), mechanical/plumbing (2), roof (2), site/civil (1), structural (1) and general construction (1).*

*The high level of internal inspection capability added to the inspection duties of the construction management firms, the A/E firms, the commissioning agents and the City Schools' project managers assigned to each construction management firm will add yet another layer to the team investigating the quality of the construction on the block grant projects.*

*The participation of the Authority's Project Directors in construction status meetings, review of the monthly reports, inspection of plans, documents and construction activities offer another layer of quality control.*

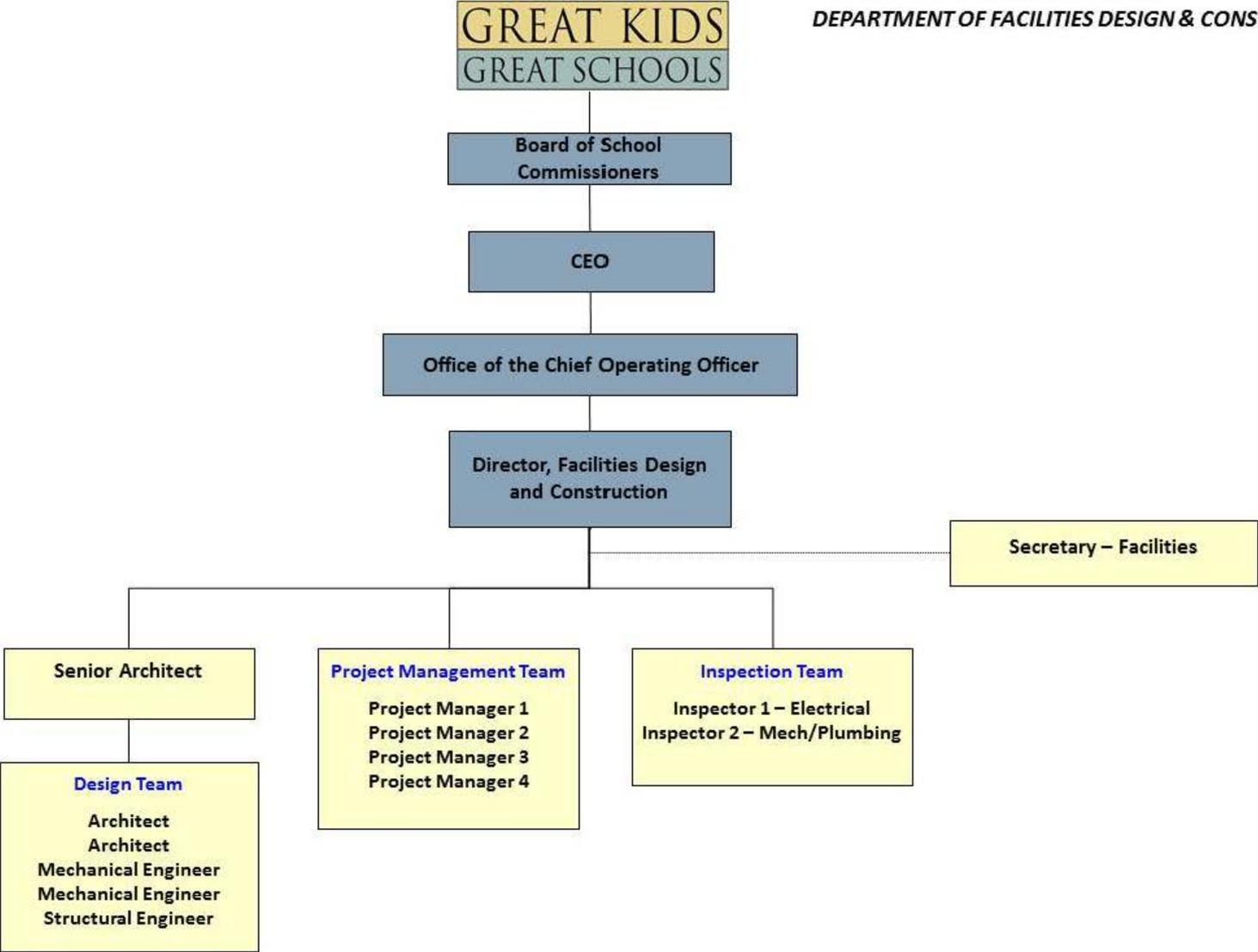
### **Financial Management**

*For the accountability requirements of the financial management plan, please see the financial plan attached as an appendix and prepared by the Office of the Chief Financial Officer.*

## **ENDNOTES**

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- <sup>i</sup> Scientex Corporation and The 21<sup>st</sup> Century School Fund, "Public School Capital Improvement Programs; Basic Elements and Best Practices," Guidance for the District of Columbia, July 1999.
  - <sup>ii</sup> Ibid, page 25.

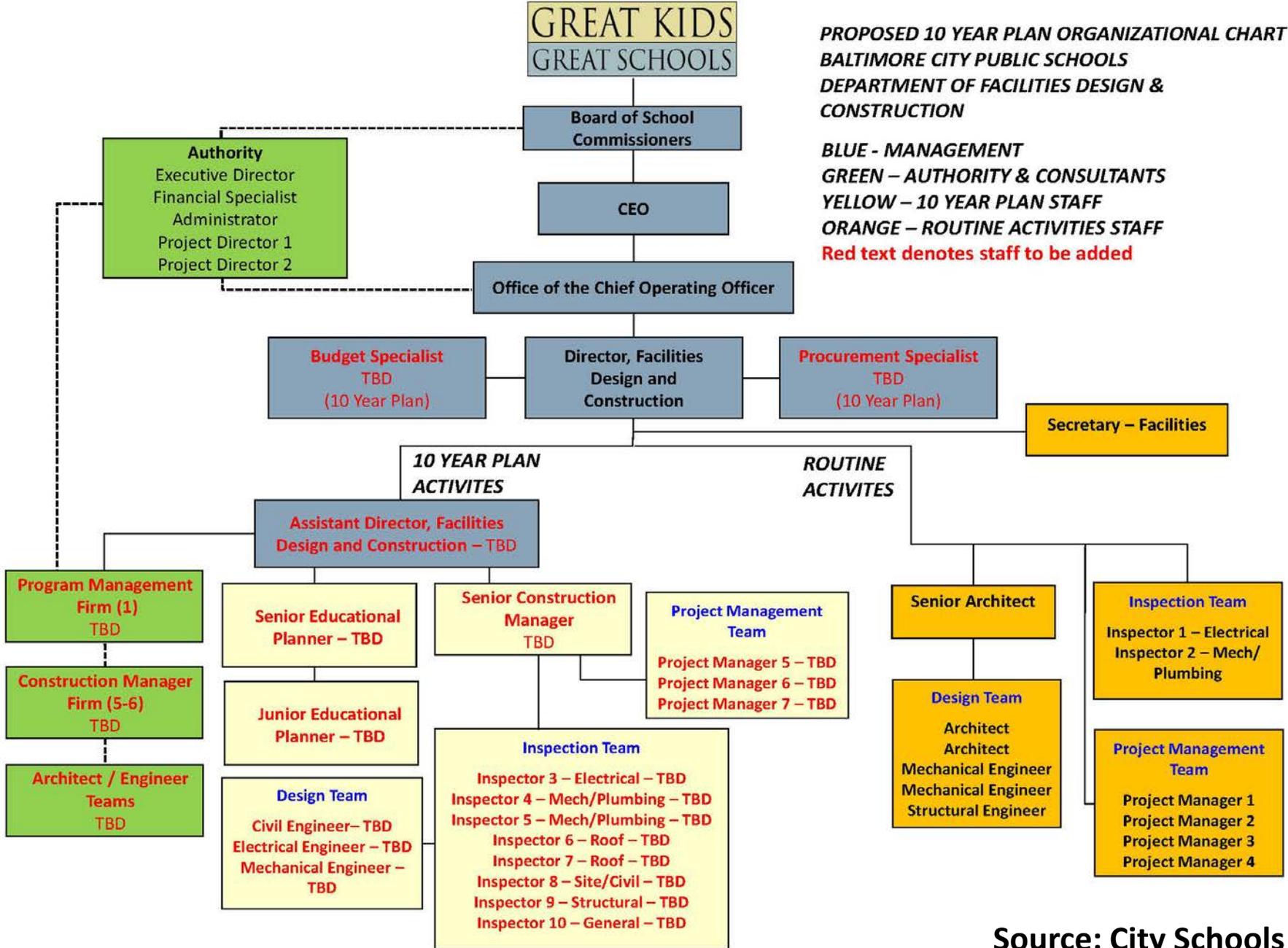
*EXISTING ORGANIZATIONAL CHART  
BALTIMORE CITY PUBLIC SCHOOLS  
DEPARTMENT OF FACILITIES DESIGN & CONSTRUCTION*



**GREAT KIDS  
GREAT SCHOOLS**

**PROPOSED 10 YEAR PLAN ORGANIZATIONAL CHART  
BALTIMORE CITY PUBLIC SCHOOLS  
DEPARTMENT OF FACILITIES DESIGN & CONSTRUCTION**

**BLUE - MANAGEMENT**  
**GREEN - AUTHORITY & CONSULTANTS**  
**YELLOW - 10 YEAR PLAN STAFF**  
**ORANGE - ROUTINE ACTIVITIES STAFF**  
**Red text denotes staff to be added**



## CHAPTER V: THE USE OF BLOCK GRANTS IN THE UNITED STATES

<p><b>JRC Topic 6: Examine how other states have implemented such a block grant and the benefits and consequences of doing so</b></p>
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### DEFINITION OF A BLOCK GRANT

The concept of block grant funding is not new in American government. The first block grant funding at the federal level was enacted by Lyndon Johnson in 1966 to support health related programs at the state level. This development led to a study in the 1970s by the Advisory Commission on Intergovernmental Relations that officially defined a block grant as "a program by which funds are provided chiefly to general purpose governmental units in accordance with statutory formula for use in a broad functional area, largely at the recipient's discretion."<sup>i</sup> However, for the purposes of this report the concept of a block grant simply means providing funding in a lump sum payment with limited restrictions on the use. In the case of Baltimore City Public Schools, this means specifically that school construction allocations would no longer be tied to individual projects and would instead be available as a funding stream to support alternative financing.

The concept of block grants is a familiar one in Maryland. In addition to administering federal assistance delivered via block grant, Maryland administers its own Disparity Grant program, which functions by allocating lump sums of money to local jurisdictions. The funds may be used for a broad range of educational purposes. Initiated in 1991, the Disparity Grant program was designed to address the differences in the ability of the local jurisdictions to raise revenues from the local income tax, or the differences in their taxing capacity. The purpose of the Grant is to improve fiscal equity among jurisdictions by making less affluent jurisdictions less dependent on their own tax base to fund public services. Baltimore City and seven counties (Allegany, Caroline, Dorchester, Garrett, Prince George's, Somerset, and Wicomico) qualified for Disparity Grant funding in fiscal 2010 and continue to qualify in fiscal 2012.<sup>ii</sup>

As proposed through House Bill 304 and Senate Bill 533 during the 2012 session of the General Assembly, a block grant is understood to be a lump sum payment of funds that the State would allocate each year to support the financing of public school capital improvements in the City of Baltimore without being tied to a specific project. As described in Chapters II and III, this approach is intended to allow the city to use the block grant to leverage a large third party bond issuance that will address the school construction needs of the city. This approach differs substantially from the method of capital fund allocation that has been in place since 1971 in the Public School Construction Program, in which funds are allocated on a project-by-project basis.

### USE OF BLOCK GRANTS NATIONWIDE

Over the past decade, states have assumed a greater responsibility for school construction funding. As they have recognized the need for the use of innovative financing programs to meet their school

construction needs, several states have seized on the concept of providing localities with predictable streams of funding that could be leveraged to address capital infrastructure needs. Fourteen states currently provide local school districts with some form of lump sum funding for school infrastructure needs.<sup>iii</sup> Not all of these allocations are labeled as “block grants.” Examples of the use of lump sum and flexible funding concepts can be found in every region of the Country, including Arizona, Florida, South Carolina, Tennessee, Utah and West Virginia. Many more state governments distribute funding for school infrastructure through a combination of lump sum and flexible matching aid.

**New York State** is a prime example of State aid distributed as a block grant which can be used by a local school system for leveraging a large building program. In New York, the State provides building aid to construct, renovate, purchase, or lease school buildings. State aid is a percentage of total project costs and is based on district wealth. A regional cost factor accounts for disparities in the cost to build and repair school facilities across the state. The following expenses are eligible for building aid: (a) principal and interest payments for bonds, bond anticipation notes, and capital notes sold to finance building projects, (b) capital expenditures from budgetary appropriations, (c) expenditures from capital reserve funds, (d) debt service payments on installment contracts, and (e) lease expenditures. See Chapter VI for a discussion of how the State assisted the Buffalo school district to carry out the renovation and replacement of 74 schools.

**Arizona**, which does not use its funds to leverage third party financing, also provides school construction capital funds through three lump sum grant programs. The State’s Building Aid formula is adjusted to account for property wealth.

- ***New Schools Facilities Program.*** The *New Schools Facilities* program is administered as a continuing appropriation to school districts for the purpose of constructing new school facilities. Money is distributed to a school district upon submission and approval of a 5-year capital plan that demonstrates a need for additional space, or for replacement of school facilities that do not meet minimum standards. From fiscal year 1999 to 2012, 309 projects were funded at a total expenditure of \$2.6 billion, or about \$184 million per year. The average project allocation was \$8.3 million.
- ***Building Renewal Program.*** The *Building Renewal* program addresses ongoing maintenance of school facilities. The program is funded through monies appropriated by the legislature for the purposes of maintaining the adequacy of existing school facilities. \$693.2 million was spent in this program between FY 1999 and 2010.
- ***Emergency Deficiencies Correction Program.*** The *Emergency Deficiencies Correction* program addresses serious and emergent needs for materials, services or construction, or for expenses in excess of the district's adopted budget for the current fiscal year, to correct deficiencies that seriously threaten the functioning of the school district, or for the preservation or protection of

property or public health, welfare or safety. Over a ten-year period, this fund expended \$1.3 billion on 9,002 projects to remedy problems identified in Arizona's 1,200 schools.

Although these grants are awarded as block grants, as with other forms of capital funding state-level constraints have been established to ensure that the funding is spent as it was intended. LEAs receiving funding must first submit a district-wide facilities assessment and 5-year capital plan to the School Facilities Board. The Board then uses the 5-year projections of capacity and projected costs to determine the grant. Proposed renewal and new construction programs must comply with the guidelines established by the State Department of Education.

The Arizona programs allow local school districts to maintain their current buildings and expand when necessary without being solely reliant on their local tax base. Over the past decade, the State has invested in some of the worst and most over-crowded facilities throughout the state.

### **BENEFITS AND CONSEQUENCES OF BLOCK GRANTS FOR SCHOOL CONSTRUCTION**

In general, the principle benefit of a block grant for school construction is the flexibility it offers the recipient to use the funds for a broad range of projects and for a wide range of applications within those projects. By contrast, Maryland's Public School Construction Capital Improvement Program is prescriptive not only as to the types of projects that are eligible, but also as to how the funds are used. This arrangement has the advantage of fully protecting the taxpayer's monies: funds are allocated for a specific purpose, in a specific amount, and there is a trail of accountability to ensure that the funds are used for the intended project and for the intended purpose within the project.

However, the traditional method of allocation may also entail certain disadvantages for the recipient of State funds. Under the general principle outlined in Chapter II that tax exempt bond proceeds are intended to support the acquisition of assets, CIP funds cannot be used for a variety of "soft" costs: architectural/engineering fees and other pre-construction services, furniture and equipment, commissioning, etc. Since the funds are allocated to a specific project within an approved CIP, they cannot be readily transferred from one project to another; to do so requires an amendment to a prior year CIP. In many cases additional funds cannot be added to a project even if the construction bid exceeds the budget, because the State's funding level is established by formula. While changes in some of these practices may be needed in order to implement a block grant program, it must be recognized that these are more than administrative matters, but involve the policies of the State.

## ENDNOTES

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- <sup>i</sup> The Brookings Institute Center on Children & Families, “Block Grants: Flexibility vs Stability in Social Services” Policy Brief, December 2005
- <sup>ii</sup> Under the Disparity Grant program, counties with per capita income tax revenues less than 75% of the statewide average are eligible to receive a grant equal to the dollar amount necessary to raise the county’s per capita income tax revenues to 75% of the statewide average. By statute, the distributions are recalculated each year with the most recently available data, generating year-to-year variations in the resulting distributions.
- <sup>iii</sup> Duncombe, William and Wang Wen, “School Facilities Funding and Capital Outlay Distribution in the States,” *Journal of Education Finance* 3(34) Winter 2009, 324-350

## CHAPTER VI: A THIRD PARTY SCHOOL CONSTRUCTION ENTITY

### JCR Topic 7: Study the creation and governance of a third party entity for school construction purposes in Baltimore City

#### THE USE OF THIRD-PARTY ENTITIES

Nationwide, school systems and other levels of government are increasingly relying upon third-party entities to develop innovative ways to solve their infrastructure needs when, for a variety of reasons, state and local governments are unable to fully address critical school facility needs. The reasons for electing to use a third-party entity outside of the traditional school system fall into one or more categories, four of which will be discussed: Financing; Program Management; Capitalizing on Private Industry Expertise; and Accountability. Since not every locality seeks all of these benefits, the agreement between the public and the third party entity may be customized to meet the specific needs of each situation.

In the context of school construction for Baltimore City, a third party entity should be required to meet the following criteria:

- Debt issued by the entity must be independent of debt issued by the State or the City, to ensure that the bond ratings and the debt affordability criteria of each government are not affected;
- The governing structure of the entity must represent the City, the State, and the Board of School Commissioners, so that the interests of each level of government are fully accounted for in every aspect of decision-making;
- A linkage must be established through a memorandum of understanding or other instrument between the entity and the Interagency Committee on School Construction (IAC) to ensure that the requirements and procedures of the IAC are adhered to.

#### Financing

Financing a complete overhaul of a district's school buildings is costly, and due to fiscal and debt limitations, many jurisdictions have reluctantly been forced into a short term, small scale approach to fixing their schools – plugging leaks and patching holes – as long as their sole source of funds consisted of annual allocations from their state and/or local government. Access to large sums of money upfront is necessary in order for a school district to abandon this approach and implement instead a large scale plan to fully renovate and build new schools to high standards. The use of a third-party financing entity by jurisdictions with limited capacity to issue new debt may, if properly constructed and managed in accordance with a well-conceived business plan, achieve the benefits outlined in more detail in Chapter III: to accelerate the delivery of modern and educationally-adequate facilities, to avoid construction cost escalation, to reduce the maintenance, utility and operating cost burden, and to capitalize on

efficiencies of scale. In these cases, the third-party entity assumes the responsibility and risks associated with issuing debt to finance construction or acquisition of new facilities. This debt is then retired through structured agreements via the use of government revenue in the form of grants, bonds, or taxes paid over time.

### **Program Management**

Third-party entities can effectively address management capacity concerns when the scale or scope of a building program is beyond the capacity or ability of a school district, local government, or state agency to manage. Depending on State law, regulation, and policy, the third party may also have the ability to use alternative procurement methodologies and processes and may enter into contracts with outside design, finance, program management, and construction vendors. This allows the third-party entity the flexibility to streamline the procurement process in order to meet deadlines and provide the level of expertise required to effectively plan, manage, and execute large programs. Additionally, for large-scale programs such as Greenville's, comprehensive program management, whether through the school district or a third party, allows for bulk purchasing of materials and other efficiencies, leading to additional savings. In Greenville, bulk purchasing was an important component, contributing to the reported \$800,000 in avoided costs.<sup>i</sup> Such outside program management capacity, however, does not reduce the need for the public owner to maintain continuous, effective, and forceful oversight of every aspect of the program, from project scoping to design, procurement, construction, and operations.

### **Capitalize on Private Industry Expertise**

Third-party entities have been used effectively to harness the resources and talent of private industry for public projects. Where risks and responsibilities are collaboratively shared between the third-party entity and the public body, this arrangement is commonly referred to as a public-private partnership, or a P3. In the landscape of dwindling public resources, P3s are becoming more popular, as government entities seek to address their needs by tapping into the creative skills, management efficiencies, and project productivity of the private sector. However, to ensure a high-quality project, government officials and the involved private groups must comprehensively develop and understand the complex details and mechanics of the P3 agreement beforehand, to ensure that all parties know their responsibilities before signing a contract.

The United Kingdom, Canada, and Australia have effectively carried out P3 school projects under a design-build-finance-maintain-operate (DBFMO) arrangement.<sup>ii</sup> In this arrangement, a private entity assumes the risk not only for the design and construction of the project, but also for its finance and for a range of maintenance and operational services that are mutually determined with the public owner; the public owner repays the financing through an accessibility payment made over as many as 30 years. The DBFMO arrangement has only recently been applied in the United States to social infrastructure, most notably in the Long Beach, California Court House, which is scheduled to open in 2013.<sup>iii</sup> The Maryland Public School Construction Program is currently working with five LEAs, including Baltimore City Public Schools, and the Maryland Department of Planning to investigate the applicability of this method to our school construction task. Enabling legislation was passed as a component of the Public School Facilities

Act of 2004; to date, however, only Washington County Public Schools has taken advantage of its provisions to carry out a true P3 project, the Barbara Ingram School for the Arts in Hagerstown.

### **Accountability**

In situations where the school district and local and state governments are each contributing resources to capital programs, questions of authority and accountability can arise. Third-party entities, either with independent or representative boards, can offer a governance structure in which each party's interests, as well as those of the public, will receive fair consideration, and can provide a framework in which all parties have confidence in a transparent and thorough accountability process. Such a structure is particularly important with respect to school projects in order to allay community concerns that the availability and quality of the school facility will not be the same as it would be under public ownership and management, and that funds supported by the taxpayers will be used in the interests of students and communities.

### **TYPES OF THIRD-PARTY ENTITIES**

#### **The "63-20" Nonprofit Corporation**

A 63-20 nonprofit corporation is established by a governmental unit under a specific IRS ruling that enables a nonprofit corporation that meets stringent criteria to issue tax exempt "63-20" bonds to benefit the public. This type of nonprofit corporation can also serve to oversee certain aspects of construction for the public. "63-20" refers to the section of the IRS code that governs this type of nonprofit corporation. Establishing a 63-20 follows a similar process to the creation of any other nonprofit and does not require specific legislation or a referendum.<sup>iv</sup> These corporations have been used as vehicles to finance the construction of public buildings and infrastructure such as hospitals, courthouses, bridges and schools. Such arrangements allow governments to leverage private investment and stretch public financing dollars further, and they can be structured to provide oversight and accountability for a public project.

Specific requirements for establishment of a 63-20 nonprofit corporation include:<sup>v</sup>

1. The corporation must engage in activities which are essentially public in nature;
2. The corporation must be created under the state's general nonprofit corporation law (and must not be organized for profit, except to the extent of retiring indebtedness);
3. The corporate income must not inure to any private person;
4. The state or political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain legal title to the property of the corporation with respect to which the indebtedness was incurred upon the retirement of such indebtedness; and

5. The corporation must have been approved by the state or political subdivision thereof, either of which must also have approved the specific obligations issued by the corporation.<sup>vi</sup>

While a 63-20 can be created by a school board or another governmental entity for the purpose of school construction, ensuring adequate accountability and control of the corporation is critical. Articles of Incorporation, which must be filed to legally establish the entity, also serve to outline the basic structure of the corporation by defining its purposes and the rights and liabilities of shareholders and the board of directors. The corporation's by-laws serve as the operating framework for the entity, providing rules and procedures for issues such as how to appoint new board members, and establishing formal rules for the decision-making process.<sup>vii</sup>

A 63-20 nonprofit corporation may be granted powers to undertake activities related to its purpose. Generally, these powers with respect to properties may include: owning; using; purchasing; taking and holding by lease; or granting any real or personal property necessary to carrying out its mission. Likewise, the corporation can: sell; convey; mortgage; create a security interest in; lease; exchange; or transfer its property and assets in accordance with its mission. Like a regular corporation, the 63-20 can also: enter into contracts and guarantees; incur liabilities; borrow money; issue bonds; and secure any of its obligations by mortgage or security interest in its property and income. The corporation can also develop partnerships with other corporate entities.<sup>viii</sup> Within the powers granted by the establishing body, a 63-20 could acquire land and develop it through contracts with private contractors for the design and construction of the facilities, and enter into agreements with public and/or private entities for projects.

Establishing a 63-20 nonprofit corporation allows the public sector to create an entity tailored specifically to its needs. Since the purpose, mission, and decision-making framework are determined by the establishing documents, the entity can be customized to deliver a very specific, high-quality program. Additional contracts can be used to clarify the relationships between the newly-established entity and the school board, city government, and state government as necessary. These contracts, and effective communications between the public and private entities, are necessary to ensure a successful project.<sup>ix</sup> The flexibility of a new 63-20 corporation could be an asset when formulating a comprehensive plan for a large school construction program. Since the corporation essentially starts as a "blank slate," it can be shaped and modeled into the most advantageous vehicle to renovate or rebuild the schools in the district, whether it is used for financing only, or in a broader multi-faceted role that may also include design, construction, and operations.

Possible advantages of using a 63-20 nonprofit could include: (a) the ability to create a governing structure that includes representatives from both the public and private sectors; (b) the transfer to the private sector of significant project risk, while preserving the ability to finance the project through the issuance of tax-exempt debt; (c) insulating public agency sponsors from financial or other liability; (d) the ability to receive and utilize federal, state and local government grants or loan proceeds; (e) enabling participation by other nonprofit organizations; and (f) combining the relative strengths of the

public sector with the private sector's value-added efficiency and innovation in ideas.<sup>x</sup> Additional advantages are outlined in the endnote.

### **School Construction Authorities**

A construction authority is a quasi-public corporation chartered by a state or another public body with the intent to perform some public benefit. The authority generally takes on a managerial role, such as the maintenance of public infrastructure, and often has broad powers to regulate or maintain public property. The structure of the authority is similar to that of a private corporation, with a board of directors overseeing management and operations pursuant to adopted bylaws, and staff with the expertise necessary to complete the authority's mission. Unlike private corporations, however, public authorities do not have shareholders, and their board members are appointed by elected officials or are defined by statute.<sup>xi</sup> The Maryland Health & Higher Education Facilities Authority (MHHFA), the Maryland Stadium Authority (MSA), and the Maryland Economic Development Corporation (MEDCO) are examples of public authorities established by the General Assembly. The Charles Village Community Benefits District Management Authority and the Midtown Community Benefits District Management Authority are examples of public authorities established by the Baltimore City Council.

Most construction authorities have the power to issue bonds without voter approval in order to develop and maintain infrastructure, such as roads and schools, or to fund projects for public agencies or private parties. The debt service for these bonds is usually supported by project revenues, such as tolls levied by bridge and tunnel authorities, as is the case with the Maryland Transportation Authority. Some authorities, such as the New Jersey Schools Development Authority, rely on appropriations from the legislature. The state may also assign specific revenue streams to an authority as a way to guarantee its debt service payments. In New York City, leaders and the school system created such an entity, the New York City School Construction Authority, which is responsible for the construction and renovation of all New York City public schools.<sup>xii</sup>

Construction authorities, as described by Lavine, can achieve efficiencies through the flexibility of the third party entity to improve upon the more cumbersome, costly and lengthy requirements of the public sector, such as those related to procurement processes. She notes, "Although public authorities are subject to financial reporting requirements and other oversight measures under state law, they are not required to comply with the same regulations that apply to public agencies."<sup>xiii</sup> However, this flexibility may come at a cost if the creation of a construction authority also adds an additional layer of bureaucracy and management to the overall process, possibly slowing down progress and adding additional expenses to the program. In addition, the independence and flexibility of the authority should not jeopardize important State and City interests that are tied to school construction funding, for example minority business enterprise requirements or high performance school requirements. These requirements, as well as the procedures that will balance the need for quick action with appropriate oversight by the public, must be included in the statute that establishes the construction authority as well as in any binding instruments that are written to govern day-to-day management of the program.

## **CASE STUDIES**

### **Greenville County Public Schools, Greenville, South Carolina**

The Greenville, South Carolina school district needed approximately \$1 billion to completely overhaul its school facilities, but the district only had the capacity to issue \$60 million in bonds each year for school construction. Greenville had approximately 80 schools in need of major renovation, expansion, and repair. Because of the limited amount of money available for school construction each year, Greenville had been strictly limited to dealing with systemic failures and keeping the schools running as best as possible, rather than improving the educational quality of the schools. In order to have any hope of providing quality school buildings, district leaders believed that funding for the \$1 billion building task needed to be acquired up front.

To solve its problem, the Greenville school board formed a 63-20 nonprofit corporation, Building Equity Sooner for Tomorrow (BEST). Under an installment-purchase agreement (IPA) with the school district, BEST obtained a partial ownership interest in the school buildings, issued \$1 billion in bonds and implemented a mass-scale construction program. Greenville's 63-20 corporation only allows former school board members to be appointed to the board of directors, thus ensuring that individuals on the board understand the goals, mission, and vision of the school board. Most of Greenville's 80 schools were replaced, and the rest were fully renovated within six years. Over a 25 year period, the Greenville school board will issue a portion of its \$60 million annual bond authorization to purchase the capital assets back from BEST. BEST uses the school district payments to retire its \$1 billion in bond issues. BEST did not take ownership of the schools, but will continue to hold an undivided interest in the buildings until the last payment is made.

Institutional Resources Financial, LLC (InRe), a group of finance and construction experts, was hired by BEST to manage the financing, design, and construction of the \$1 billion program. BEST also hired a consultant to serve as the liaison between the school district and InRe. The Greenville school district developed an internal maintenance plan to ensure its facilities would remain in good condition over the course of the repayment period and in the decades beyond. Greenville is reported to have saved an estimated \$1 billion in construction costs through uniform design standards, bulk purchasing, and avoidance of projected construction cost escalation had the construction occurred under the traditional system over 20 years.

Subsequent to the financing arrangement described above in Greenville and other South Carolina counties, the State legislature passed legislation that requires voter approval for any school district lease-purchase financing agreement after 2006, if that arrangement would incur debt above 8% of total assessed value of the taxable property in the county. Further research is needed to fully understand the reason for this change.

### **Buffalo Public Schools System, Buffalo, New York**

Traditionally, Buffalo sold general obligation bonds for school construction and renovation, and was reimbursed by the State education authority. Buffalo's 78 school facilities had an average age of 70 years, and few new schools had been built in the city over the previous quarter century. To address this

problem, the Mayor and City Council partnered with the Buffalo school district to develop and implement a 10-year plan to rebuild all of the city's school facilities. The city charter was amended to create the Joint School Construction Board (JSCB), a third party entity empowered to provide assistance to the school district and to oversee the construction of new schools and the renovation of existing schools throughout the city. To guarantee that funds would be expended in accordance with the approved plan, each governmental body was given representation on the JSCB. Buffalo's \$1.3 billion plan includes a total of 48 fully renovated schools, with building consolidations and closures.<sup>xiv</sup> Construction began in 2002 and is expected to be completed by 2015. In order to accomplish this goal in a short period of time, the program required a new financing model to secure the funding for construction up front.

Buffalo Public Schools, working with city leaders, chose the Erie County Industrial Development Agency as a conduit issuer for School Facility Revenue Bonds. These bonds are backed by education aid payments from the State of New York, which provides a secure flow of funds that would not be affected by Buffalo's fiscal crisis and credit issues (see Chapter V). Buffalo's plan used both the lease purchase and installment purchase financing models. To prevent default on payments, a mechanism was established by which all State aid to education for capital improvements due to the City from the State Comptroller flowed first into a trust account. Funds in the trust account were then withheld to make lease or installment payments on a pro-rata basis determined by the expected flow of State aid receipts, with the remainder flowing to the City's General Fund. Unlike most other school construction projects in New York, the cost of the financing was not borne by the local government. In all of the City's previous school district financings, the State had provided facilities education aid for approximately 94% of the lease or installment purchase payments on the bonds issued to finance the project; the City had been responsible for its local share. By contrast, for the School Facility Revenue Bonds, the City's local share was fully provided for by financing innovations, including the use of innovative investment products, the structuring of debt payments to specifically match the flow of State aid, and financial contributions from the private program manager. Consequently, the cost of the capital improvements was not borne by the taxpayers of the City of Buffalo.<sup>xv</sup>

In order to implement such a large capital program, a private company was chosen to act as the Program Manager, to manage the financing, design, and construction of Buffalo's schools. The school district worked with the Program Manager to develop a structured contracting plan to target small businesses and minority- and women-owned firms. Large and small contracting opportunities were created for these businesses, which previously had not been able to compete with the larger, established firms. Smaller firms were encouraged to participate in the reconstruction of Buffalo's public schools. The program management firm also created a contractor training program in order to teach new and small business owners how to evaluate, bid, and document contracts.<sup>xvi</sup> The JSCB played an integral role in the review of contracts, audits and construction progress reports, and in providing transparency, accountability, and opportunities for public input.

The Buffalo Public School System is now in Phase IV of the five-phase, \$1.3 billion schools reconstruction project, in which all schools will be renovated and will have updated information technology, with smart

boards in every classroom. To date, approximately 41 schools have been fully renovated or rebuilt, and the remaining seven will be completed by 2015. Buffalo's school construction program is also Western New York's largest historic preservation effort to date. According to the January 2010 Buffalo Public Schools Program Annual Report, two phases of the construction program had been completed; the third phase was substantially complete; the fourth phase was moving into construction; and the fifth phase was in the early planning stages. This last phase includes roughly \$350 million in renovations and additions to nine schools and is expected to be completed in 2014.<sup>xvii</sup> The benefits of leveraging the State's lump sum funding are clear. This program has allowed Buffalo to improve all of the city's school facilities in a relatively short period of time and at a significant cost savings to the tax payers of the city. In addition to avoiding construction escalation costs and continued deferred maintenance, the city was able to use the alternative financing mechanisms along with the construction management team to provide the local share of the program (see additional information about the Buffalo plan in Chapter VI).

#### **Yonkers Public Schools, Yonkers, New York**

In Yonkers, city leaders and the school system have created a third-party entity called the Yonkers Education Construction Fund (YECF) to represent their interests in a public-private partnership. Currently, state law and the "junk bond" rating of the city prevent the local jurisdiction from acting on its own behalf, but in the third-party arrangement, YECF will be able to use private equity to build mixed-use real estate projects that create new instructional space and potentially generate revenue for the City and school system, while also capitalizing on the financing, design, management, and construction expertise of the private market. The Yonkers capital program is still in the planning stages. The LEA has selected a program/financial management team to guide the process, and is currently working through the details with the State of New York.<sup>xviii</sup> The DBFMO model described above is under consideration by the school system: a financial adviser has been engaged to assist the system in developing the best combination of program scope and risk transfer arrangements.

#### **Indianapolis Public Schools, Indianapolis, Indiana**

Similar to the school districts mentioned above, Indianapolis was facing a facilities crisis and lacked the funds necessary to address the need. Because of a State-imposed debt limit, funds were insufficient to embark upon the large-scale capital program necessary to bring Indianapolis city schools to 21<sup>st</sup> century standards. To deal with this challenge, the State of Indiana allows school districts to establish not-for-profit holding companies that act as conduit issuers to secure funding for a 10-year capital program. The holding corporation is governed by a Board of Trustees made up of three private citizens.

The \$832 million Indianapolis program to renovate or rebuild 72 schools was broken into four phases, each financed by an installment purchase agreement between city schools and the holding corporation. The Indianapolis holding corporation issued the majority of the debt associated with the public school construction program, and will be repaid by the school district over time. To secure the debt, the public school system transferred ownership of the school facilities that were under development to the holding corporation, which in turn signed a management agreement granting exclusive use of the facilities and management of the facilities to Indianapolis Public Schools. Ownership of the school facilities will revert back to the school system upon repayment of the outstanding debt.

Since the Indianapolis school district has independent taxing authority, installment purchase payments were made, at least in part, through a specific capital program levy approved by the voters through consensus or ballot initiative. The remainder of the funding for the project was obtained through debt issued by the school system and through capital funding from the state.

This program differed from the scenario used in Greenville in that the not-for-profit holding company was used only as a financing vehicle for the school district. Consequently, the Indianapolis Public School system used its existing vehicles for procurement and construction services to take advantage of the American Reinvestment and Recovery Act (ARRA) funding that became available in 2009 and 2010, resulting in significant savings for the taxpayers during Phase 3 of their program. Indianapolis currently expects Phase 3 of their plan to be completed in 2014.<sup>xix</sup>

### **New Jersey School Development Authority**

In response to the Abbott v. Burke court rulings of 1985, which required the State to fund the “cost of remediating identified lifecycle and infrastructure deficiencies” in school buildings and the cost of new construction necessary “to house students adequately” in the state’s highest poverty school districts (the Abbott districts), the New Jersey Legislature passed the Education and Facilities Construction and Financing Act in July of 2000. This act authorized the New Jersey Economic Development Authority to borrow up to \$6 billion for construction projects in Abbott districts, which educate over 20% of all students in the state, and an additional \$2.5 billion for projects in non-Abbott districts to ensure parity in facilities between the poorer Abbott Districts and the more affluent districts within the state.<sup>xx</sup> In 2002, Governor McGreevey signed Executive Order #24 establishing the New Jersey School Construction Corporation under the authority of the Economic Development Authority to manage the construction program for the state.<sup>xxi</sup>

Under the Corporation, the school construction program ran into significant fiscal problems, which were exposed in late 2004. Due to lack of internal cost controls and poor financial management, it became clear there were not enough funds available to finish all the projects that had been originally identified, including some that had already begun design. This led to a comprehensive audit of the program released in March of 2006, identifying a variety of internal control failures and poor decision-making as the main causes for the fiscal mismanagement (see Chapter II, p. 14). In addition to the audit, Governor Jon S. Corzine issued Executive Order No. 3 of 2006 in February 2006, creating an Interagency Working Group on School Construction to study management reforms and legislative action necessary to improve the school construction program.<sup>xxii</sup>

The Interagency Working Group on School Construction recommended statutory changes, including the creation of a new school construction authority with a specific focus on Abbott district construction; a governance structure tailored to its mission; project implementation requirements to ensure that projects are undertaken consistent with educational priorities; land acquisition and procurement reforms to improve efficiencies, provide flexibility, and control costs; and a greater role and responsibility given to the Abbott districts in managing certain types of projects.<sup>xxiii</sup>

These recommendations led to the creation of the School Development Authority (SDA) in August of 2007.<sup>xxiv</sup> This new entity was granted an additional \$3.9 billion in bonding capacity in July 2008 to continue the work the School Construction Corporation had failed to complete.<sup>xxv</sup> As of March 31, 2012 the Authority had been authorized to issue \$12.5 billion in bonds, and it has issued a total of \$8.649 billion of this capacity. Currently, the SDA has \$2.2 billion of ongoing work in the state.<sup>xxvi</sup> Since 2002, the efforts in New Jersey have resulted in over 100 new schools opening in urban districts, and the completion of a substantial number of health and safety repairs.<sup>xxvii</sup>

### **IMPLICATIONS OF A THIRD-PARTY ENTITY FOR BALTIMORE CITY SCHOOLS**

Delivering state school construction dollars to Baltimore in a “block grant” that can be used in an installment purchase arrangement or another alternate funding/financing structure would allow Baltimore to engage a third-party entity for financing. The ability of a third party entity to issue tax exempt bonds at a reasonable cost depends on the reliability of the revenue streams that are developed to repay the debt; a defined commitment of State funds in a block grant format is conceived of as an essential element of the revenue stream. As decisions are made at the local level about which entity to use, it is important to understand how each of the entities will interact with the State and the local government, as they are the sources of revenue for paying back the large amounts of up-front borrowing. The state and City governments, as well as the school district, must be assured that their money will be invested effectively and efficiently, and that the school construction projects will be of high quality and built according to proper standards.

In Maryland, the Public School Construction Program (PSCP) and its management board, the Interagency Committee on School Construction (IAC), were formed to ensure effective use of State dollars in school construction projects, and they have a proven track record established over many decades. These structures have the expertise and authority to review and approve projects (and in this case, to comment on an overall plan), and to intervene when necessary to assure quality, accountability, and compliance with various State standards and policies such as competitive procurement requirements, minority business enterprise participation, prevailing wages rates, and high performance schools requirements, as applicable. Under any third-party structure that is established, agreements must be implemented to ensure the full involvement of the PSCP in many project management issues and of the IAC in many aspects of project approval and contract award.

### **ENDNOTES**

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<sup>i</sup> <http://www.greenville.k12.sc.us/Departments/docs/fac.plan.pdf>

<sup>ii</sup> These programs are summarized in Canadian Council for Public-Private Partnerships, “Schools: The Case for a Canadian PPP Application”, November 2007

<sup>iii</sup> Governor George Deukmejian Court House website <http://www.longbeachcourthouse.com>

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- iv AASHTO Center for Excellence in Project Finance, "Non-Profit 63-20 Corporations," 2011, [http://www.transportation-finance.org/funding\\_financing/legislation\\_regulations/state\\_local\\_legislation/63\\_20\\_non\\_profit\\_financing.aspx](http://www.transportation-finance.org/funding_financing/legislation_regulations/state_local_legislation/63_20_non_profit_financing.aspx).
- v Internal Revenue Service, "Module B: Introduction to Federal Taxation of Municipal Bonds," Training Manual (2011).
- vi Under Maryland law, this transfer of title is essential in order to allow the State of Maryland to provide funding through the Capital Improvement Program.
- vii Nossaman LLP, "The Use of '63-20' Nonprofit Corporations in Infrastructure Facility Development," June 1, 2001, <http://www.nossaman.com/the-use-6320-nonprofit-corporations-infrastructure-facility>.
- viii Ibid.
- ix Qingbin, PhD Cui and Jay, PhD Lindly, "Evaluation of Public Private Partnership Proposals," University Transportaion Center for Alabama, June 2010, [http://ntl.bts.gov/lib/33000/33100/33140/08402\\_Final\\_Report\\_6-2-10.pdf](http://ntl.bts.gov/lib/33000/33100/33140/08402_Final_Report_6-2-10.pdf).
- x Nossaman op. cit.,

The American Civil Liberties Union (ACLU) has provided the following additional information on the 63-20 concept:

*Additional advantages of a 63-20 corporation may be mentioned. Unlike an authority that requires statutory approval and a bureaucratic structure in order to function, a 63-20 could be created by the Baltimore School Board, and could consist solely of a voluntary board of directors. The 63-20 could be entirely focused on the intricacies of financing the school construction program, with adequate oversight and accountability through a well thought-out and balanced board of directors. The 63-20 board can be set up to have adequate representation from the State, City, and community, including finance experts from the private sector. Appropriate by-laws and contracts would outline the powers of the board. The 63-20 board could be tasked primarily with arranging the financing to allow implementation of the construction plan approved by the Baltimore City Board of School Commissioners; execution of the projects would remain with the Board of Commissioners staff and their consultants and contractors. As appointees of the Governor and Mayor, the School Board is responsible for making decisions for the school system, and would maintain the power to approve the school construction plan and priorities, as well as the overall financing plan. This would ensure that decisions about the quality of schools and the educational needs of students are the primary concern of the school construction program.*

*In terms of implementation of the school construction program, the 63-20's purpose will be involved in matters that relate directly to financing, not in determining the priorities, choosing projects, or managing the contracts. All aspects of the construction program could be managed within the city school system, given adequate capacity with additional expert staff, to maintain its working relationship with the PSCP. Given the large scale of a complete overhaul of city school buildings, another layer of oversight should be required to ensure that projects are being implemented efficiently and according to high quality standards (see Chapter IV, Management of the Program).*

*An additional benefit of a 63-20 is the distance it provides to the City and the State from the debt issuances. The legal flexibility that a 63-20 provides is well-suited for this goal, as this was one of the intended purposes for the creation of this type of nonprofit entity. Using a 63-20 as the financing mechanism for the plan provides an additional layer of security for the City and the State, and prevents a situation where the debt is considered state-supported, similar to the Maryland Stadium Authority. Unlike some authorities, the debt incurred by a 63-20 also clearly would not be based on the full faith and credit of either the state or the city.*

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- xi Lavine, Amy, "What are public authorities," September 7, 2011, Public Authorities: A Blog About Public Authorities in New York (a Project of the Government Law Center at Albany Law Schools) <http://publicauthorities.wordpress.com/2011/09/07/what-are-public-authorities/> .
- xii New York City, NY Public School Construction Authority, <http://www.nycsca.org/AboutUs/Pages/OurWork.aspx>
- xiii Lavine, op. cit.
- xiv Joint Schools Construction Board, City of Buffalo, 2013-16 Proposed Four Year Plan [www.bfsa.state.ny.us/Docs/Misc/jscb001.pdf](http://www.bfsa.state.ny.us/Docs/Misc/jscb001.pdf)
- xv Buffalo Public Schools Program Annual Report, January 15, 2004, <http://portal.lpciminelli.com/portal/site/bps>.
- xvi The Bond Buyer, "Buffalo, NY Schools to sell \$185M," September 8, 2003.
- xvii LPCiminelli, Inc., "Seventh Annual Progress and Status Report," Buffalo Public Schools 2010.
- xviii Yonkers Public Schools, "Yonkers Public Schools Selects Macquarie Capital, Freshfields Bruckhaus Deringer LLP, and URS Corporation as Advisors for Historic P3 Project," <http://www.yonkerspublicschools.org/1112news-3P-Advisor-Announcement.php>
- xix Irwin-Knott, Colette, "Umbaugh Advises Indianapolis Public Schools on Indiana's Largest School Construction Program" 2012. <http://www.umbaugh.com/services/our-experience/umbaugh-advises-indianapolis-public-schools-on-indianas-largest-school-construction-program>.
- xx New Jersey State Department of Education, Educational Facilities Construction and Financing Act, [http://www.nj.gov/education/facilities/laws/act\\_summ.shtml](http://www.nj.gov/education/facilities/laws/act_summ.shtml).
- xxi State of New Jersey, "Executive Order Number 24," July 29, 2002, <http://nj.gov/infobank/circular/eom24.htm>.
- xxii State of New Jersey, State of New Jersey Executive Order No. 3, February 7, 2006, <http://nj.gov/infobank/circular/eojsc3.htm>.
- xxiii State of New Jersey, School Development Authority, 2011, <http://www.njsda.gov/GI/Overview.html>.
- xxiv Construction and Financing of Public School Facilities, Laws of New Jersey, 2007, P.L. 2007 c. 137.
- xxv State Support for School Facility Projects. Laws of New Jersey, 2008. P.L. 2008, C. 39.
- xxvi State of New Jersey Schools Development Authority, "Moving Forward with a New Approach to School Construction: Biannual Report of the School Facilities Construction Program for the Period of October 1, 2011 through March 31, 2012," (2012).
- xxvii Education Law Center, Issues – School Facilities, <http://www.edlawcenter.org/issues/school-facilities-program.html>, (2012).

## CHAPTER VII: CITY SCHOOLS BONDING AUTHORITY

### JCR Topic 8: Evaluate the current bonding authority of the Baltimore City School System and whether the amount is adequate

The State of Maryland passed Senate Bill 773 / House Bill 745 in 2000 authorizing City Schools to issue up to \$25 million in debt. This limit was increased over time so that the present limitation for the amount of bonded debt outstanding may not exceed \$100 million. In the 2012 session of the General Assembly, City Schools requested that a \$150 million increase in its debt capacity be provided to bring the total debt capacity to \$250 million (SB 242 / HB 612).

City Schools indicates that increasing the district's bonding authority is an integral part of the overall capital plan. The largest part of the capital plan is the 10-Year Plan, in which City Schools proposes to use capital revenue streams in the form of guaranteed annual State and City block grants to raise the first \$1.13 billion of the \$2.45 billion required for its construction and renovation needs.<sup>i</sup> The figure of \$1.13 billion corresponds to the projects that will respond to the criteria outlined in the Introduction under "Establishing Priorities and Individual Project Scopes":

- Schools that will accept students from closing schools,
- Schools that have the most overcrowded and poorest buildings,
- Schools that have large amounts of excess space, or
- Schools that have an impact on community development

For estimating purposes, an annual revenue stream of \$69 million has been assumed to be needed to support the initial \$1.13 billion in improvements.<sup>ii</sup> City Schools' financial adviser, Vantage Point, is currently developing concepts for the revenue stream that will support the remaining \$1.32 billion of the 10-Year Plan.

While the total \$2.45 billion 10-Year Plan addresses the replacement and improvement needs of City School facilities, it does not represent the full capital needs of the district. City Schools will also need to maintain its existing assets through life cycle capital investments and preventative and corrective maintenance, and to retain the flexibility to deal with emergencies and unplanned capital investment requirements. These ongoing capital costs will be applied to existing assets during the 10-year construction period as well as the new 10-Year Plan assets as warranties expire.

City Schools intends to rely primarily on its internal debt capacity to provide capital funding for these routine capital investments and unforeseen capital projects. City Schools currently estimates that on average \$39 million per year will be invested for these purposes for the first fifteen years and on average \$91 million per year will be invested for these purposes in the subsequent fifteen year period.

These ongoing capital investments are in addition to the \$2.45 billion that has been identified in the 10-Year Plan.

In addition to City Schools bond revenues, other sources to support the ongoing and unplanned capital investment needs will consist of:

- Revenues received from existing sources above the guaranteed funding levels (example: any State capital funding received in excess of the an annual block grant amount);
- Revenues received from City tax revenues devoted to City Schools' capital program above Year 1 values, including any tax revenue growth over the next thirty years (example: any bottle tax revenues received in excess of the anticipated \$8 million);
- A portion of operating budget savings related to utility and overhead expenses; and
- An operating budget contribution of \$5 million per year.

City Schools currently has \$28.9 million in outstanding debt that is subject to the State debt limit; this debt is being repaid through the City Schools general fund. This leaves \$71.1 million available to be issued. Given current and proposed capital funding streams and the capital funding needs of City Schools, City Schools believes that the existing \$100 million debt limit imposed by the State is not sufficient to assure that there will be sufficient capital funding capacity.

The \$100 million increase along with the existing available capacity of \$71.1 million would provide City Schools with \$171.1 million in bond proceeds to be used for unplanned and ongoing capital needs outside of the 10-Year Plan. Depending upon the life of the capital improvements made with these bond proceeds, it is expected that the financing terms would likely range from ten to fifteen years. This would allow the available debt capacity to be replenished two to three times within the next 30 year period. Finally, the existing outstanding debt of \$28.9 million will also be repaid within this timeframe, further increasing the total amount of funds available for these purposes.

The current School Debt Policy of the Baltimore City government limits debt service on all City School debt, including capital leases and loan guarantees, to no more than 5.0% of the current total general fund operating budget. Over the next few years City Schools has approximately \$18 million in annual debt service that is subject to City Schools' debt policy, amounting to 1.6% of the current total general fund operating budget. If an incremental \$171 million of debt is incurred, the associated incremental annual debt service is estimated to be approximately \$14 million. This would bring total debt service subject to City Schools' debt policy to \$32 million, or 2.5% of the projected general fund operating budget, remaining well below the 5% cap.

## ENDNOTES

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- <sup>i</sup> The \$2.45 billion figure does not include fixtures, furnishings and equipment (FFE) or construction escalation costs
- <sup>ii</sup> In Chapter III, a revenue stream of \$66 million per year was used to explain the impacts of implementing the 10-Year Plan using block grants from the State and the City to repay a third-party bond issuer. The figure of \$69 million used in this chapter reflects adjustments made by Vantage as of November 14, 2012, consisting of:
  - 1. Rather than \$15 million per year for the City's portion of the block grant, \$17 million is now included given the approved level of funding for the next two years.
  - 2. The second item is due to rounding: \$2.5 million is projected as the revenue from video gaming, which rounded up to the nearest million appears as \$3 million.

## CHAPTER VIII: APPLICATION TO MARYLAND'S SCHOOL CONSTRUCTION NEEDS

<p><b>JCR Topic 9: Evaluate whether the results of this study could be applied to other jurisdictions with significant school facility needs</b></p>
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It has been established in this report that the school construction situation in Baltimore City is critical, and that the concept of pooling fiscal resources from the City and State governments and partnering with a third entity to leverage current levels of capital funding for financing school construction projects is feasible if properly constructed, with appropriate oversight by the City, the Board of School Commissioners, and the State. But could this approach work for any of the 23 other local educational agencies (LEAs) in Maryland?

### VARYING CAPITAL NEEDS

The Interagency Committee on School Construction (IAC) is charged with recommending how to allocate capital funds equitably to school districts throughout the state – a significant challenge, considering the disparate circumstances of Maryland's twenty-four LEAs, and the limits in the availability of capital funds.

Across the state, each school district functions in a different environment that impacts its school construction needs and capabilities. Baltimore City has an urban school system in a densely-populated, built-out metropolis, with the oldest school facilities in the state and improvement needs that far exceed the capital resources of its local government. Wicomico County, an Eastern Shore district in an area that was once primarily farmland, is now experiencing some population growth and development, but is still struggling economically. Allegany County is in a largely rural, mountainous district in Western Maryland, where population growth has leveled off. These three LEAs are vastly different in many ways – for example, in the size and demographic composition of their populations and public school enrollments, in the ways in which each of their local governments function, in the resources available to them, and in their school facility needs.

As dissimilar as they are, however, there is one commonality they share: their low-wealth status increases their reliance on the State's contributions for school construction funds. Currently, the cost formula for determining the maximum State funding participation in the eligible costs of City Schools construction projects is 93% State, 7% City; for Wicomico County, it is 96% State, 4% local; and for Allegany County, 93% State, 7% local. The State participation percentages, which are based on each jurisdiction's wealth and other factors defined in regulation (COMAR 23.03.02.05), cover only eligible project expenses.<sup>i</sup> This percentage governs the State's maximum funding participation in the eligible expenses of individual projects that are approved within the annual Public School Construction Capital Improvement Program (CIP); it does not represent the total relative contribution that the county or city, and the State, make for a specific project or for the LEA's total capital program each fiscal year (for

example, Baltimore City contributed a total \$17 M, or 29%, in the FY 2013 CIP while the State contributed \$42.6 M, or 71%).

By contrast, there are large, relatively urbanized LEAs such as Anne Arundel, Howard and Montgomery counties in which intensive overcrowding in some locations, aged facilities, and a very complex demographic structure generate an equally complex set of facility needs. The extent of the needs can overwhelm even the more adequate financial resources of these wealthier jurisdictions. In the case of Montgomery County, rapid student enrollment growth triggered by the economic recession has compounded the magnitude of the capital improvement program. Currently, the State-local share cost formulas for maximum State participation in those school districts' school construction projects are 50%/50%, 60%/40% and 50%/50%, respectively (50% has been established as the minimum level of State participation in eligible project expenses). In some cases, Howard and Montgomery counties have been able to forward-fund school construction, paying for certain projects in full up front in order to address their capacity needs, then seeking reimbursement for State funds later.

Mid-size LEAs have their own special facility circumstances. Prior to the beginning of the current economic recession, these jurisdictions experienced the most intensive growth, driven by their relatively less expensive housing in combination with their proximity to major employment centers. During this period, attention to the existing building plant necessarily took second place to the construction of new capacity. With the current abatement of growth, these jurisdictions have an increased ability to address their older buildings, but concurrently they are experiencing severe constraints on their fiscal capacity due to the same cause, the decrease of population growth and the consequent decline in the property tax base.

These complex circumstances are reflected in the estimates that have been developed of facility deficiencies across the State. While the results of different estimating methods vary considerably, the net observation is that Maryland's schools require a very large investment of State and local resources to achieve adequate facilities:

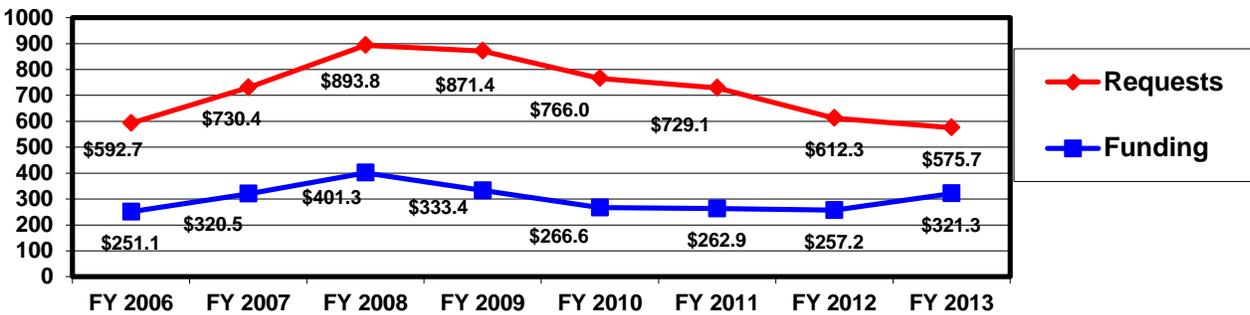
- **2003 Adequacy Survey.** In 2003, the Task Force to Study Public School Facilities (known as the Kopp Commission, after Treasurer Nancy K. Kopp, chair of the Task Force) determined that \$3.85 billion in combined State and local funds was needed to bring all of Maryland's school facilities to *minimum* standards of building performance and educational adequacy. For a variety of reasons, it is thought that this figure did not represent the full needs of the jurisdictions at that time. However, if the \$3.85 billion figure were adjusted to today's construction costs, the deficiencies noted at that time would require in the range of \$6 billion to correct. This figure does not account for investments that have taken place since the study was conducted, for the continuing cost to improve building systems that have not been addressed since 2003, nor for new educational mandates and initiatives that may have affected the educational adequacy of schools in the interim. The Task Force recommendation that funding be provided for the State's \$2 billion share of the estimated deficiency cost of \$3.85 billion was written into the Public School Facilities Act of 2004 as an

uncodified goal to allocate \$250 million per year in the CIP for fiscal years 2006 through 2013, a goal that has been met or exceeded by the State in every fiscal year.

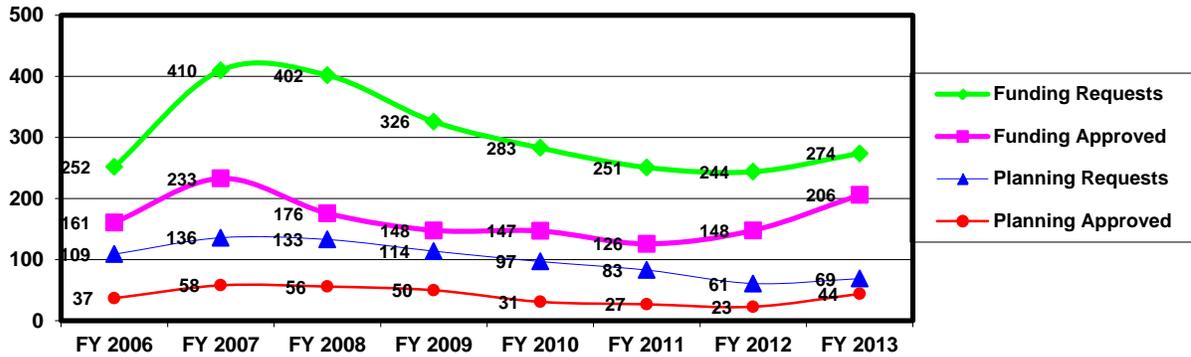
- Capital Improvement Program Projections.** Each year, with their request for CIP funding for the budget year, LEAs are asked to submit projections of their capital improvement program requests to the State for the following five fiscal years. In combination with the budget year request, these cumulative requests in the FY 2013 – FY 2018 CIP totaled \$3 billion (\$3.3 billion if adjusted at an annual construction cost escalation rate of 4%). Under an assumption that the State funds pay for roughly one half of the total cost of the projects requested, the State funding figure equates to approximately \$6 billion, corroborating the figure developed in the Kopp Commission survey, as adjusted for construction cost escalation between mid-2003 and mid-2012. However, these future figures are notoriously unreliable; analysis shows that actual following year requests tend to vary widely from the estimates provided in the annual CIP. Moreover, these figures do not include any of the many projects that are funded entirely with local funds. The nature of capital improvement program funding in Maryland requires that local governments seek State CIP dollars only for projects for which they can provide their local share of the construction costs, and for projects that are eligible within the categories approved in regulation by the Board of Public Works. For that reason, a number of LEAs, particularly those with limited local wealth, do not indicate the full spectrum of their facility needs in their CIPs. Some LEAs have been unable to address some of their school construction needs on a timely basis, due to the lack of local capital resources.

The charts below illustrate the amount that each of Maryland’s 24 LEAs requested for school construction projects over the past three fiscal years, the allocation amounts, and the differences between the expressed need and the State funding. For the past eight fiscal years, the Governor of Maryland and the Maryland General Assembly have dedicated more than \$250 million annually to the state’s school facilities program. Clearly, even with the State’s best efforts to address the need, there is a notable gap between what LEAs request in their capital improvement programs (CIPs) and what the State can provide. The following charts provide a graphic sense of the disparity between the needs expressed in the CIP and the available funding:

**CHART 1: FY 2006 - 2013 CIP Requests and Funding**



**CHART 2: FY 2006 - FY 2013 CIP  
Project Requests: Planning and Funding**



**SUMMARY OF MARYLAND LEAs  
STATE CIP REQUESTS vs. ALLOCATIONS  
FYs 2011, 2012 and 2013**

LEA	FY 2011			FY 2012			FY 2013		
	REQUEST	ALLOCATION	DIFFERENCE	REQUEST	ALLOCATION	DIFFERENCE	REQUEST	ALLOCATION	DIFFERENCE
Allegany	\$842,000	\$842,000	\$0	\$603,000	\$603,000	\$0	\$741,000	\$741,000	\$0
Anne Arundel	\$61,121,000	\$26,000,000	\$35,121,000	\$42,884,000	\$27,400,000	\$15,484,000	\$42,041,526	\$33,300,000	\$8,741,526
Baltimore City	\$87,532,241	\$28,559,000	\$58,973,241	\$62,854,000	\$32,000,000	\$30,854,000	\$74,582,000	\$42,600,000	\$31,982,000
Baltimore County	\$144,202,759	\$29,000,000	\$115,202,759	\$78,874,139	\$32,000,000	\$46,874,139	\$70,028,070	\$43,300,000	\$26,728,070
Calvert County	\$14,492,200	\$8,450,000	\$6,042,200	\$6,907,000	\$6,907,000	\$0	\$7,018,100	\$7,018,100	\$0
Caroline County	\$3,767,061	\$3,676,061	\$91,000	\$86,000	\$86,000	\$0	\$700,000	\$350,000	\$350,000
Carroll County	\$12,157,031	\$8,444,000	\$3,713,031	\$20,323,000	\$8,905,246	\$11,417,754	\$14,336,605	\$12,747,549	\$1,589,056
Cecil County	\$1,743,536	\$1,743,536	\$0	\$2,414,000	\$2,414,000	\$0	\$1,514,000	\$1,514,000	\$0
Charles County	\$15,835,495	\$8,335,000	\$7,500,495	\$17,596,685	\$1,769,000	\$15,827,685	\$8,200,000	\$8,000,000	\$200,000
Dorchester County	\$8,938,000	\$5,436,000	\$3,502,000	\$3,502,000	\$3,502,000	\$0	N/A	N/A	N/A
Frederick County	\$68,059,518	\$14,000,000	\$54,059,518	\$53,010,476	\$16,300,000	\$36,710,476	\$37,141,000	\$19,091,541	\$18,049,459
Garrett County	N/A	N/A	N/A	\$384,000	\$332,606	\$51,394	N/A	N/A	N/A
Harford County	\$28,612,378	\$13,834,534	\$14,777,844	\$25,014,845	\$16,205,845	\$8,809,000	\$15,706,610	\$14,511,610	\$1,195,000
Howard County	\$30,475,000	\$18,290,014	\$12,184,986	\$43,438,000	\$22,936,206	\$20,501,794	\$37,738,000	\$32,490,000	\$5,248,000
Kent County	N/A								
Montgomery County	\$139,127,000	\$30,183,398	\$108,943,602	\$163,477,000	\$33,000,000	\$130,477,000	\$184,521,000	\$43,106,000	\$141,415,000
Prince George's County	\$62,415,662	\$29,500,000	\$32,915,662	\$55,696,737	\$31,348,000	\$24,348,737	\$57,662,837	\$40,375,288	\$17,287,549
Queen Anne's County	\$7,024,000	\$5,750,000	\$1,274,000	\$5,195,000	\$5,195,000	\$0	N/A	N/A	N/A
St. Mary's County	\$6,673,000	\$6,600,000	\$73,000	\$3,063,814	\$3,063,814	\$0	\$2,314,000	\$2,314,000	\$0
Somerset County	\$6,000,000	\$6,000,000	\$0	\$3,257,283	\$3,257,283	\$0	N/A	N/A	N/A
Talbot County	\$344,000	\$344,000	\$0	N/A	N/A	N/A	N/A	N/A	N/A
Washington County	\$15,124,000	\$7,970,000	\$7,154,000	\$9,119,000	\$8,400,000	\$719,000	\$9,418,000	\$9,000,000	\$418,000
Wicomico County	\$14,609,425	\$9,975,425	\$4,634,000	\$14,597,000	\$1,597,000	\$13,000,000	\$12,070,000	\$10,808,000	\$1,262,000
Worcester County	N/A								
<b>Statewide Totals</b>	<b>\$729,095,306</b>	<b>\$262,932,968</b>	<b>\$466,162,338</b>	<b>\$612,296,979</b>	<b>\$257,222,000</b>	<b>\$355,074,979</b>	<b>\$575,732,748</b>	<b>\$321,267,088</b>	<b>\$254,465,660</b>

Sources: Maryland Public School Construction Capital Improvement Programs Approved by the Board of Public Works for Fiscal Year 2011 (January 20 & May 19, 2010), Fiscal Year 2012 (January 26 & May 4, 2011) and Fiscal Year 2013 (January 25 & May 23, 2012)

- **Facility Assessment Studies.** A number of LEAs have conducted facility assessment studies. The cumulative total for deficiencies identified in the six largest jurisdictions in Maryland is

approximately \$13.5 billion; extrapolated for the mid-size and smaller LEAs, it is clear that the total statewide figure would exceed \$15 billion. Although the facility assessment method is the most accurate basis for establishing capital funding needs, certain caveats must be exercised in the use of these figures. First, different methods are used by different LEAs: one LEA may assess only building performance issues, another may include minimal educational deficiencies, and a third may include the full range of educational deficiencies. Second, not all of the items identified are necessarily of the same urgency. Many deficiencies can be accommodated through schedule or administrative adjustments, and even certain code deficiencies in existing facilities do not represent a threat to the health or safety of the current occupants and can be safely deferred until the building is renovated.

Despite these caveats, the magnitude of the number does provide some sense of the variance between the needs and the funding that LEAs seek from the State and their local governments.

### **APPLICATION OF THE BLOCK GRANT METHOD TO OTHER SCHOOL DISTRICTS**

The large need for school construction funding in Maryland suggests that the State and the local governments must find efficient and cost-effective alternatives to the traditional funding mechanism. The research included in this study indicates that the use of block grant funding in combination with the creation of a third-party finance entity is both legal and feasible under Maryland statute. The model of a state block grant to a local jurisdiction in order to support alternative financing payments is one that can be applied not only to Baltimore City, but potentially to LEAs across the state.

To date, only Baltimore City Public Schools has expressed an interest in using this method. In developing strategies to address their school infrastructure needs, it is critical for each district to look closely at its needs and its fiscal capacity in order to determine the most effective method for using available State and local funds. Factors that each school system must consider include:

- Scope of the local capital program.
- Support of local decision-makers for the capital program.
- Anticipated levels of local and State funding.
- Willingness of the local board and local government to make long-term fiscal commitments, considering that these commitments may limit their flexibility to respond to emergent and emergency issues in the future. Long-term commitments may require local governments to seek additional revenues, including raising taxes or establishing other means. For example, the City of Baltimore has already taken steps to expand revenue by passing the five-cent bottle tax and dedicating a percentage of future slots revenue and potential table game revenues to the school construction program.

- Local staff capacity to manage the enlarged capital program.
- Local interest in exploring other alternative financing approaches, e.g. the design-build-finance-maintain-operate model used in the United Kingdom, Canada, and Australia.
- Ability to team with other LEAs to achieve efficiencies in the allocation of staff and consultant resources and to take advantage of economies of scale in the purchase of materials and equipment.

The expansion of the block grant/third party financing approach to other LEAs will also depend on the State. While IAC has found that the concept proposed by City Schools is likely to be successful if certain staffing and organizational structures are put in place to manage the 10-Year Plan, and affirms both that, subject to testing of an actual proposal by the bond rating entities and the federal government, it is a legal method and does not impair important State interests (in particular the State's bond rating, its capital debt affordability calculation, or the oversight role of the IAC), it also raises a number of concerns related to the management of the ambitious capital program. The experience that City Schools will attain in the execution of the 10-Year Plan will be of invaluable assistance to other LEAs that may consider using the same methodology.

However, these same concerns will apply to any other LEA that undertakes such an ambitious capital improvement program: the capacity of the local staff to manage the program; adherence to State requirements and best facility management practices; and developing binding instruments that will govern the responsibilities and rights of the parties involved and that will transcend changes of administration and political leadership. In addition, before it can offer its support for an expansion of the program to other LEAs, the IAC must also assess the impact that the City Schools block grant program will have on its own operations and ability to deliver services to 23 other jurisdictions and the Maryland School for the Blind.

## ENDNOTES

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<sup>i</sup> Examples of ineligible expenses include furniture, furnishings, computer equipment, architectural/engineering and other planning expenses, and square footage that falls outside of the State's calculated gross area allowance for major projects.

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DATE: March 24, 2011

TO: Valerie Green, Esq.  
Baltimore City Public Schools

George Nilson, Esq.  
Baltimore City Department of Law

FROM: Elliott Schoen  
Deputy Counsel

SUBJECT: School Construction Block Grants

You have asked for my views regarding the State's authority to distribute school construction funds in block grants to local school systems. Your January 10, 2011, letter reasons that current Maryland law does not prohibit block grant distribution so long as "each project ultimately aided out of those block grant funds complies with applicable regulations and procedures."

In my review, I consulted with the Executive Director of the Interagency Committee on School Construction and with Counsel to the State Treasurer to obtain their policy and legal views regarding your proposal. I also reviewed Maryland statutes, regulations, and the Public School Construction Program Administrative Procedures Guide. While I did not find a statute that expressly prohibits a block grant distribution methodology, legal, administrative, and policy issues were identified that make such distribution legally questionable.

Currently, the State distributes school construction funds to local school systems by direct payments to construction contractors or vendors in the form of a check drawn on the State Treasury or paid to the local school system as reimbursement by the State Treasury for properly approved invoices up to the limit of approved State funding. (Public School Construction Program, Administrative Procedures Guide, 306.2 (March 4, 2003)). The proposal in your letter is a significant departure from the existing methodology for distributing school construction funds.

**State Fiscal Policy**

The first issue concerns how block grant distribution would impact current State fiscal policies. Since local education agencies are State entities for certain fiscal purposes, from a federal tax standpoint, State General Obligation ("G.O.") Bond funds

would not be “expended” if they were transferred as a block grant to local school systems. In the view of the IRS, the G.O. Bond funds would merely be transferred from one State pocket to another State pocket. Because the proposed block grants would not constitute an expenditure of G.O. Bond funds, the funds would remain on the State’s books until expended on actual third party (contractors’) expenses. Accordingly, the State would have to track the actual expenditure of the G.O. Bond funds, or require the local school system to provide a detailed, auditable accounting of expenditures. This is required by federal tax rules, which include yield restrictions on investment of bond funds, the calculation and reporting of arbitrage (i.e., earnings on bond investments), and the payment of rebates to the federal government if required.

Moreover, in 2003, the General Assembly enacted legislation that placed the State’s Capital Fund on a cash-flow basis in order to take advantage of a safe-harbor provision under the federal tax code. If bond funds are fully expended within two years, there is no requirement to track and report arbitrage or pay rebates to the federal government. As a practical matter, this means that bond funds are expended for eligible projects on what amounts to a first-come, first-served basis. This has resulted in State G.O. Bond funds generally being expended within 6 to 8 months of a bond sale. They are not placed in separate accounts for authorized projects. If there is a G.O. Bond authorization on the books, G.O. Bond funds can be expended on that project’s expenses. Distributing G.O. Bond funds as block grants could lead to delays in spending the funds and take the State out of the safe-harbor provision.

### **Control and Investment of Block Grant Funds**

Another issue concerns the control and investment of block grant funds. Arguably, until expended, block grant funds would retain their character as “State money” and would have to be invested according to law. Investments would be restricted as provided by State Finance and Procurement Article, §6-222 (generally to obligations of the U.S. and U.S. agencies, as well as other enumerated obligations), or would have to be held in banks approved by and under contract with the State Treasurer, per State Finance and Procurement Article, §6-229. It is questionable whether local education agencies would have the capacity and resources to manage the investment of State money as required by law.

In short, because local education agencies are State entities, and because the Public School Construction Program is currently funded with proceeds from the sale of State G.O. Bonds, certain provisions of the federal tax code would apply to any block grants made to local school systems. These tax code provisions would create a challenging administrative burden for both the State and the local school system. Additionally, block grants would impact certain State fiscal policies, including cash-flow accounting for the State’s capital program and the investment of State funds.

### **State Administration**

In addition, the block grant proposal raises staffing issues for the State, and may require an increase in the number of State personnel that will be needed to ensure accountability for funds and compliance with State procurement and design

requirements. Additional personnel may need to be hired to ensure that the State funds are used for educational purposes only; are applied to eligible projects, and to eligible items within those projects; do not support unneeded expansions of scope or other wasteful practices; and are used in projects that are well-designed to support educational purposes and are well-constructed to ensure durability and good building performance.

Because an increased level of detailed oversight would be necessary if funds were distributed on a block grant basis it would be essential to work out well in advance the protocols, procedures, forms, and communication requirements that would ensure appropriate State oversight. It is not hard to envision that a considerable effort would be needed to address potential issues, including revision to regulations and policy guidance. It is also clear that an increase in IAC staff resources would be needed to adequately monitor the block grants.

**Conclusion**

In summary, I did not find a statute prohibiting block grant distribution of State school construction funds, however, significant legal, policy, and administrative issues present road blocks to such distribution. If Baltimore City wishes to pursue this avenue of reimbursement, I would recommend that it be done by statute with full legislative consideration of all the issues involved. Do not hesitate to contact me if I can be of further assistance.

**ADVICE OF COUNSEL  
NOT AN OFFICIAL OPINION OF THE ATTORNEY GENERAL**

## **Baltimore Education Coalition**

### ***Comments on: Joint Chairmen's Report request for "Report on providing a block grant for school construction."***

**Prepared: August 29, 2012**

The Baltimore Education Coalition is made of up 26 member organizations who have worked together since 2009 under the common mission of ensuring that all children in Baltimore City receive an excellent education. Over the past four years, the BEC has worked with city and state legislators to prevent more than \$125 million in proposed cuts to state funding for Baltimore City Schools. This past year, the BEC played a key role to secure passage of the city's bottle tax for school construction – a historic and unprecedented victory that will guarantee more than \$155 million in leveraged funds for school construction. The BEC has done this with the *Transform Baltimore: Build Schools, Build Neighborhoods* campaign by organizing thousands of parents, teachers, community members, and students from more than 40 affiliated schools and many other City schools.

We are committed to securing funding for a full and immediate renovation and revitalization of Baltimore City Public School facilities, so that every child can learn, and every teacher can teach, in a school facility that meets their needs. The BEC decries the deplorable conditions in which students and teachers are asked to work each day, and recognizes the unique opportunity before us all now to transform our city through renovating and building new schools. A full-scale overhaul of the city's school buildings is possible and can be done now. It remains to be seen only whether we as a city and state have the collective will and desire to complete such a critical undertaking.

Given our commitment to this campaign, we have, at the invitation of the Interagency Committee on School Construction work group, compiled a set of comments on the nine points for consideration laid out in the Joint Chairmen's Report request for a report on providing a block grant for school construction. Please consider this letter and the attached "Transform Baltimore Comments from Schools Fall 2011" as a part of the official record of the work group.

- (1) Together with Mayor Rawlings-Blake and BCPS CEO Dr. Andres Alonso, the BEC welcomed the release of the Jacobs study in June of 2012. This study affirms in great detail what we have known by experience to be true: that the condition of school facilities in Baltimore is very poor and will continue to get much worse and much more costly if strong action is not taken now to address the problem.
- (2) The provision of a block grant for school construction purposes to Baltimore City Public Schools is absolutely feasible. Other school districts, most notably that of Greenville, South Carolina, have demonstrated that the provision of a block grant for school construction is a feasible, legal, and effective strategy for addressing facilities needs on the scale of those seen in Baltimore City. With proper state,

city, and community oversight, the BEC has full faith in the ability of Baltimore City Public Schools to effectively manage this block grant.

- (3) The State of Maryland cannot afford to continue the current process by which school construction is funded in Baltimore City. The implications of not providing a block grant as expeditiously as possible are significant, on both an economic and human scale. If we continue with the process as it stands now, the vast majority of Baltimore's students will never have the opportunity to learn in facilities that are safe, modern, and properly equipped for a 21<sup>st</sup>-century education. Many studies over the past decades have concluded that student achievement, teacher retention, and graduation is negatively impacted by deficient school buildings. At the legislative hearings on the block grant bill last year, at the Baltimore City Council, and at numerous public forums in Baltimore, teachers, parents, and students have testified about the negative impact of school buildings on the health of students and school staff and the impact on student achievement. The implication of not providing a block grant and staying with "business as usual" in the provision of state and city funds are that these conditions will worsen. We have heard of children with asthma being taken to hospitals in ambulances. Teachers have described students who were literally sitting in pools of their own sweat in hot classrooms and who wore coats in cold classrooms. These conditions are unacceptable and will continue without a new approach. Students without access to science labs or libraries will continue to be expected to meet state standards just as students in the most technologically-equipped schools are. Teachers complain of the impact of buildings with poor air quality on their own health; poor building quality is a disincentive for teachers to continue their work in city schools. As the Jacobs report demonstrates, most of Baltimore's school facilities are in very poor condition. Over the next 10-years, city schools will continue to deteriorate and aging systems will fail. Please see the attached document with a sampling of comments from teachers, parents, and students about the condition of their school buildings and their hopes for change. These conditions cannot be allowed to continue but we believe they will continue and will worsen without a block grant approach that will allow more buildings to be renovated quickly.

The bill as written in the 2012 legislative session asked only for the minimum amount of capital funding directed to Baltimore City schools over the last four years. The state has managed to maintain at least a total investment of \$250 million in school construction projects over the last eight years, despite the worst economic crisis this country has seen in decades. With the state capital budget expected to swell to more than \$1.35 billion, the \$32 million requested is only a tiny fraction of anticipated capital expenditures in the years ahead. The BEC believes that the state should make the maximum effort to provide sufficient funds to remedy the facilities need.

- (4) As mentioned previously, the BEC has full faith in Baltimore City Public Schools to manage this construction work, given the proper oversight and assurance of

quality and efficiency. We note here as well the implications for job creation and job training that such a large volume of construction projects would entail. While not the specific purview of this work group, it is worth noting the significant positive economic impact that this project would hold for the city and the region.

- (5) In all of our research and analysis of the block grant, we have seen no evidence that legal and tax implications of this provision would render the block grant unfeasible. We anticipate that state leaders on such matters will join us in this assessment. The dire need for renovations and new buildings calls for an innovative and bold approach. We believe that any legal or policy barriers can be overcome, as they were in Greenville, SC.
- (6) The most commonly cited example of other states that have used their capital funds to leverage funds for a large program (as a block grant for Baltimore would do) is the state of South Carolina, particularly in Greenville County. Flexible use of their capital funding allowed Greenville to address more than \$1 billion in school facilities needs in a very brief period, with enormous benefit for the school district, the county, and their credit rating. As Brent Jeffcoat, bond council to the Greenville County School District, pointed out at a recent public presentation, the failure to act on the full need in Greenville County had in fact inhibited the County's ability to achieve a stronger credit rating. Rating authorities noted the impending fiscal liability threatened by the deterioration of their public school facilities. The Greenville program was noted as a necessary, and fiscally responsible solution to this significant and growing need.
- (7) There are many examples of third party entities that school districts and governments have used to address various infrastructure needs. Greenville is a successful example of how a third party was used to reach beyond governmental debt limitations to leverage needed funds to address their school infrastructure needs comprehensively. In our research, we have found that districts in New York, Connecticut, South Carolina, North Carolina, and Texas, to name a few, have used public-private partnerships to build schools. Various cities across the United States have overhauled their school buildings and many are planning to follow suit. To remain a competitive state, and to ensure a high quality education for all students, fixing Baltimore 's crumbling school buildings must be a high priority. In order for this to happen efficiently and expeditiously, we believe that it is important for the state and city to collaborate with the city school system on which third party entity and model is best for Baltimore.
- (8) Given that Thornton and state education aid is meant to keep teachers and resources in the classrooms, the BEC is advocating for a financing plan that leverages existing and additional city and state revenue for school construction. While we understand that City Schools needs more capacity to address severe capital needs, the burden on the school district's operating budget should be minimal; lest the constitutional guarantee of an adequate education for city students be compromised.

(9) Baltimore City and Baltimore City Schools have taken and continue to take the steps necessary to effectively manage the block grant. The Jacobs report has provided a clear and detailed picture of facilities' needs. The school system's 10-year facilities plan will provide a road map for responsibly and effectively right-sizing and renovating the district's facilities. Depending on the scale of need and capacity to locally fund capital projects, a block grant program could certainly be applied to other jurisdictions with significant school facility needs who are prepared to manage the process.