March 2016
PE 15-17-584

AGENCY REVIEW

HIGHER EDUCATION POLICY COMMISSION

AUDIT OVERVIEW

The Higher Education Policy Commission Has Yet to Complete the System Capital Development Plan or the Higher Education Facilities Information System as Required by West Virginia Code §18B-19-3

The Commission's Rules Do Not Have Clear Language on How Maintenance Reserve Funds Will Be Established to Address Expected and Unexpected Maintenance Needs

WEST VIRGINIA LEGISLATIVE AUDITOR
PERFORMANCE EVALUATION & RESEARCH DIVISION

JOINT COMMITTEE ON GOVERNMENT OPERATIONS

Senate

Craig Blair, Chair
Chris Walters, Vice-Chair
Ed Gaunch
Corey Palumbo
Herb Snyder

House of Delegates

Gary G. Howell, Chair
Lynne Arvon, Vice-Chair
Michel G. Moffatt
Jim Morgan
Isacc Sponaugle

Agency/ Citizen Members

Terry Lively
W. Joseph McCoy
Kenneth Queen
Vacancy
Vacancy

JOINT COMMITTEE ON GOVERNMENT ORGANIZATION

Senate

Craig Blair, Chair
Chris Walters, Vice-Chair
Greg Boso
Ryan Ferns
Ed Gaunch
Kent Leonhardt
Mark R. Maynard
Jeff Mullins
Douglas E. Facemire
Ronald F. Miller
Corey Palumbo
Herb Snyder
Bob Williams
Jack Yost

House of Delegates

Gary G. Howell, Chair
Lynne Arvon, Vice-Chair
Jim Morgan, Minority Chair
Martin Atkinson III
Saira Blair
Anna Border-Sheppard
Scott Cadle
Larry Faircloth
Danny Hamrick
Jordan R. Hill
Michael Ihle
Pat McGeehan
Michel G. Moffatt
Joshua Nelson
Randy E. Smith
Chris Stansbury
Mark Zatezalo
Mike Caputo
Jeff Eldridge
Michael T. Ferro
William G. Hartman
Justin Marcum
Rupert Phillips, Jr.
Peggy Donaldson Smith
Isaac Sponaugle

WEST VIRGINIA LEGISLATIVE AUDITOR

PERFORMANCE EVALUATION & RESEARCH DIVISION

Building 1, Room W-314
State Capitol Complex
Charleston, West Virginia 25305
(304) 347-4890

Aaron Allred
Legislative Auditor

John Sylvia
Director

Brian Armentrout
Research Manager

Justin Chapman
Research Analyst

Jordyn Reed
Referencer

CONTENTS

EXECUTIVE SUMMARY

The Legislative Auditor conducted a review of the Higher Education Policy Commission (Commission), pursuant to the West Virginia Performance Review Act, Chapter 4, Article 10, Section 8 of the *West Virginia Code*. The objectives of the review were to evaluate the Commission's compliance with W. Va. §18B-19-et al, related to capital projects and facilities' needs. Specifically, the audit team determined the Commission's status on completing the system capital development plan and the higher education facilities information system. The findings of this review are highlighted below.

Report Highlights

Issue 1: The Higher Education Policy Commission Has Yet to Complete the System Capital Development Plan or the Higher Education Facilities Information System as Required by West Virginia Code §18B-19-3.

- West Virginia Code requires the completion of the System Capital Development Plan (Plan) by December 31, 2011, as well as the Higher Education Facilities Information System (HEFIS); however, neither the Plan nor the HEFIS has been completed.
- The Commission claimed a decrease in its general revenue budget, and the need to develop a strategic approach for capital funding due to changing economic conditions as reasons for the Plan's delayed development.
- It is difficult for the Legislative Auditor to justify the Commission's explanations since the referenced budget cuts occurred years after the December 31, 2011 deadline.
- The timely implementation of the Plan and the HEFIS are critical for the Commission to achieve its goals related to improving and maintaining the state's higher education institutions. Failure to develop the Plan prevents the Commission from carrying out its other statutory duties that flow from the Plan.

Issue 2: The Commission Is Not Requiring Maintenance Reserve Funds Be Established to Address Expected and Unexpected Maintenance Needs as Required by West Virginia Code.

- The Commission is required by Code to ensure that its institutions generate and set aside adequate funds to maintain their properties and reduce the accumulated deferred maintenance. These institutions are to calculate necessary maintenance amounts according to a building renewal funding formula established by the Commission in the System Capital Development Plan. However, the System Capital Development Plan has not been completed.

- The Commission has put into effect a 10-percent reserve fund is to be retained from project revenues or bond funds. However, the language defining the 10-percent reserve fund will not accomplish the intent of W. Va. §18B-19-5(c)(4) because it is not a maintenance fund and the Commission describes it as a guideline, not a requirement.

- Although the Commission has a statutory duty to ensure that funds are being collected and applied to reducing the accumulation of deferred maintenance, the Commission has not made a priority of complying with this duty.

PERD's Evaluation of the Commission's Written Response

PERD received the Commission's written response to the draft on February 23, 2016. The Commission agrees with the Legislative Auditor's findings that these items should have high priority. The Commission believes it has worked within its budgetary and time frame limitations with the Legislature to meet the requirements of Code. The Commission states the Legislature has put in place a number of measures designed to ensure that its institutions have a plan to address deferred maintenance, however, no additional funding has been appropriated for these measures, and reduced state funding at its institutions has required a different approach to capital development.

The Commission concurs with the Legislative Auditor that the System Capital Development Plan should be a top priority. The Commission disagrees that the December 31, 2011 completion date for the Plan is still the deadline. The Commission believes the deadline was moved back through its legislative rule, which it submitted to the Legislature for passage in 2014. In the rule, the deadline for completion of the Plan was set back to December 31, 2014. However, the rule was not passed by the Legislature until 2015. Following the logic of basing the Plan's deadline from the rule and since the rule was passed a year later than it was intended to pass, then the new deadline for completion of the Plan would be December 31, 2015. However, the Plan is still not completed. Upon approval of the Plan, the HEFIS will be created and the data fields populated. The Commission anticipates the HEFIS to be operational before the end of calendar year 2016.

The Commission agrees that its institutions must have sufficient reserves for unexpected events that may develop that would affect operations and facilities. The Commission uses the 10- percent amount as a guideline. The Commission believes it would not be prudent to require a single reserve percentage requirement for all institutions because their characteristics and the microeconomic circumstances that they face vary considerably from institution to institution. The Commission gives hypothetical examples in it response for why it thinks it would not be prudent to have a policy to require a reserve fund for maintenance. The Legislative Auditor restates the report's finding that the Commission does not have language in its rule that requires a reserve fund for maintenance at its institutions, since the 10-percent amount for a reserve fund is a guideline and the definition of "reserve fund" stipulates that this fund is more for the purpose of paying debt service than for maintenance. The Commission needs to implement a policy to ensure that reserve funds for maintenance are required at its institutions.

Recommendations

1. *The Legislative Auditor recommends that the Higher Education Policy Commission give greater priority to completing the System Capital Development Plan, and the Higher Education Facilities Information System.*

2. *The Legislative Auditor recommends the Commission clarify language in its rule to establish and require a reserve fund for maintenance.*

3. *The Legislative Auditor recommends that the Commission adopt a policy to ensure that institutional privately-funded and mixed-funded construction projects have sufficient funds set aside for future maintenance spending.*

ISSUE1

The Higher Education Policy Commission Has Yet to Complete the System Capital Development Plan or the Higher Education Facilities Information System as Required by West Virginia Code §18B-19-3.

Issue Summary

During the 2010 legislative session, the Legislature mandated that the Higher Education Policy Commission (Commission) develop a System Capitol Development Plan (Plan) by December 31, 2011 for approval by the Legislative Oversight Commission on Education Accountability. The Plan is intended to address the deferred maintenance at higher education institutions. More than four years after the deadline, the Commission is still in the process of completing the Plan. The Commission was able to amend the deadline to December 31, 2014 when its legislative rule was approved by the Legislature in 2015. The Commission has contracted with a firm to study capital development needs of all higher education institutions. The Commission plans to submit a draft of the Plan at its March 2016 meeting.

During the 2010 legislative session, the Legislature mandated that the Higher Education Policy Commission develop a System Capitol Development Plan by December 31, 2011 for approval by the Legislative Oversight Commission on Education Accountability.

However, the Commission was also required to develop and maintain a Higher Education Facilities Information System (HEFIS) that would serve several functions, one of which is to provide needed data on facilities to calculate the Plan's renewal formula. The renewal formula would indicate the amount to be invested in facilities to minimize deferred maintenance. Although the Commission is working on developing HEFIS, no timeframe has been given on when HEFIS will be completed.

The Commission explained that the reasons for the delay in completing the Plan and HEFIS are recent budget cuts and the need to take a more strategic approach to funding facility maintenance. It is difficult for the Legislative Auditor to justify the Commission's explanations since the referenced budget cuts occurred years after the December 31, 2011 deadline. Given the importance of the statutorily-mandated projects in addressing the deferred maintenance of higher education institutions, the Legislative Auditor recommends that the Commission give these issues greater priority.

The purpose of the Plan is to address capital improvements and facility maintenance needs at West Virginia's colleges and universities and reduce the obligation of students and parents to bear the cost of higher education capital projects and facilities maintenance.

West Virginia Code Requires the Completion of a System Capitol Development Plan

West Virginia Code §18B-19-3 mandates the Higher Education Policy Commission to develop a System Capital Development Plan for approval by the Legislative Oversight Commission on Education Accountability (LOCEA) by December 31, 2011. The purpose of the Plan is to address capital improvements and facility maintenance needs at West Virginia's colleges and universities and reduce the obligation of students and parents to bear the cost of higher education capital projects and facilities maintenance. W. Va. §18B-19-3 outlines the development and implementation of the Plan. The statute states that at a minimum the Plan shall include the following:

(1) System goals for capital development;

(2) An explanation of how system capital development goals align with state goals, objectives and priorities established in articles one and one-d of this chapter and with system master plans;

(3) A process for prioritizing capital projects for state funding based on their ability to further state goals, objectives and priorities and system capital development goals;

(4) A building renewal formula to calculate a dollar benchmark that shall be collected annually and invested in facilities to minimize deferred maintenance and to provide the commission and council objective information to determine if the investments in maintenance are occurring;

(5) A process for governing boards to follow in developing and submitting campus development plans to the commission or council, as appropriate, for approval;

(6) A process for governing boards to follow to ensure that sufficient revenue is generated for and applied toward facilities maintenance;

(7) A discussion addressing how capital fees dedicated to debt service for the bond issue to be paid off in 2012 will be used after the payoff date.

More than four years have transpired since the December 31, 2011 deadline, yet the Plan has not been completed.

The Commission stated that reductions in general revenue budgets over the past three years hindered it from addressing this statute in a robust fashion.

The Commission Has Yet to Complete a System Capital Development Plan

More than four years have transpired since the December 31, 2011 deadline, yet the Plan has not been completed. The Commission provided two reasons why it was unable to meet the initial deadline. First, according to the Commission, economic conditions since 2010 made it difficult to address the Plan's development. The Commission stated that reductions in general revenue budgets over the past three years hindered it from addressing this statute in a robust fashion.

Given changes in the economic environment, the Commission stated it was necessary to develop a "strategic approach" to funding options. When asked to elaborate on the term "strategic approach," the Commission responded that relying on student fees and state funding are unstable funding strategies in the future.

Second, given changes in the economic environment, the Commission stated it was necessary to develop a "strategic approach" to funding options. When asked to elaborate on the term "strategic approach," the Commission responded that relying on student fees and state funding are unstable funding strategies in the future. Therefore, it was important to develop spending strategies that accounted for decreased funding. In order to develop this approach, the Commission found "it was necessary to acquire an understanding of the current deferred maintenance backlog, projected funding requirements, and facility utilization rates." According to the Commission, it started this strategic approach in 2010 with work on Code of State Rules (CSR) §133-12, Capital Project Management. The Commission approved this rule on December 6, 2013, and the Legislature approved it during the 2015 regular session. This rule outlines the structure of the System Capital Development Plan, including the data elements for both the building renewal formula and for HEFIS as well as extend the Plan's deadline to December 31, 2014.

The Legislative Auditor has concerns with the Commission's reasons for not completing the Plan in a timely manner. First, the budget cuts the Commission refers to did not take place until after the December 31, 2011 deadline.

The Legislative Auditor has concerns with the Commission's reasons for not completing the Plan in a timely manner. First, the budget cuts the Commission refers to did not take place until after the December 31, 2011 deadline. There were two 7.5 percent budget cuts, one in FY 2014 and the other in 2015, and a 4 percent cut for FY 2016. **There appears to have been a low priority for completing this mandate.**

The Recent Facilities Management Reports Completed by Sightlines Lays the Groundwork for Completing the Plan

The Sightlines study provides the Commission with a benchmark inventory of total deferred maintenance as of 2014. It is estimated that the total amount of deferred maintenance at the Commission's institutions is $1.2 billion.

The Commission contracted Sightlines LLC to assist in developing the Plan. The Commission's contract with Sightlines started on July 1, 2014. Per a change order authorized on August 21, 2015, the contract is ongoing until June 30, 2016 and the final cost will total $709,260. Sightlines provided the Commission with individual reports on all nine institutions under its purview, as well as the West Virginia School of Osteopathic Medicine. These reports looked at numerous issues pertaining to facility management, comparing institutions to public institutions in other states, building life-cycles, risk level for campus buildings, student density, funding sources, spending trends, operational effectiveness, maintenance backlogs, and strategies for long-term success. The Sightlines study provides the Commission with a benchmark inventory of total deferred maintenance as of 2014. It is estimated that the total amount of deferred maintenance at the Commission's institutions is $1.2 billion. The report issued in April 2015 had numerous conclusions, one of which is that an additional $50 million of annual spending is needed to address the system-wide deferred maintenance. This annual investment would eliminate the current deferred maintenance over 24 years.

The Commission indicated that the Plan will be reviewed by campus facility administrators and chief financial officers before being submitted at its March 2016 meeting.

The Commission indicated that the Plan will be reviewed by campus facility administrators and chief financial officers before being submitted at its March 2016 meeting. However, the Commission did not provide a timeframe beyond this meeting. The audit team concludes that, although incomplete, the Commission has made recent progress in the Plan's development. Timely introduction of the System Capital Development Plan will allow the State, Commission, and institutions to address the issues identified in the Sightlines analysis. **Therefore, the Legislative Auditor recommends that the Commission give priority to the completion of the Plan.**

The Commission Has Yet to Develop and Implement the Higher Education Facilities Information System.

The Legislature, in the same 2010 legislation, required the Commission to develop and maintain the Higher Education Facilities Information System (HEFIS), which would generate facilities data for the building renewal formula of the Plan.

Although development of the Plan is progressing, implementing the Plan will depend on the development of a facilities information system. Therefore, the Legislature, in the same 2010 legislation, required the Commission to develop and maintain the Higher Education Facilities Information System (HEFIS), which would generate facilities data for the building renewal formula of the Plan. The formula would incorporate the data and identify the maintenance funds needed for each institution. However, the Commission has not completed the HEFIS component of the Plan.

The Commission has not completed the HEFIS component of the Plan.

PERD asked the Commission what is the status of the HEFIS project? The agency responded:

> *The HEFIS is currently in development. The data elements for the system are being defined. The West Virginia Board of Risk Insurance Management (BRIM) has provided a file containing many of the system's data elements and the selected elements will be used to support strategic decisions at the institution and Commission/ Council levels.*

In another information request response related to the HEFIS, the Commission stated that the database system will be cloud-based and will have the capacity to import data elements from existing information systems, such as Banner and BRIM. Since the CSR §133-12-10, which defines HEFIS's data elements, was not in place and approved by the Legislature until the 2015 Regular Session, the Commission concluded that it would not have been prudent to move forward with designing the new database.

Delays in completing the database will prevent the implementation of the System Capital Development Plan's building renewal formula, since the formula is reliant on data from HEFIS.

Delays in completing the database will prevent the implementation of the System Capital Development Plan's building renewal formula, since the formula is reliant on data from HEFIS. Moreover, the Commission has not stated a timeframe on when HEFIS will be completed. **Therefore, the Legislative Auditor recommends that the Commission give greater priority to completing and implementing this database.**

Conclusion

The System Capital Development Plan, which was mandated by the Legislature to be completed by December 31, 2011, is now more than four years overdue. However, there is no definite completion date set for when the HEFIS component of the Plan will be completed. Without HEFIS, the Plan will be ineffective. The reasons given by the Commission for not completing the Plan and HEFIS in a timely manner are not compelling for not meeting the original deadline. The Legislative Auditor determines that a lack of priority is the logical conclusion. The Commission was unable to comply with the 2011 deadline, though it was able to have legislative rules passed that extended the Plan's deadline to December 31, 2014. The Commission has made progress in completing the Plan and has scheduled to have it presented at the Commission's March 2016 meeting. The timely implementation of the Plan and HEFIS are critical for the Commission to achieve its goals related to improving and maintaining the state's higher education institutions. Failure to develop the Plan prevents the Commission from carrying out its other statutory duties that flow from the Plan.

The timely implementation of the Plan and HEFIS are critical for the Commission to achieve its goals related to improving and maintaining the state's higher education institutions. Failure to develop the Plan prevents the Commission from carrying out its other statutory duties that flow from the Plan.

Recommendation

1. *The Legislative Auditor recommends that the Higher Education Policy Commission give greater priority to completing the System Capital Development Plan, and the Higher Education Facilities Information System.*

ISSUE 2

The Commission's Rules Do Not Have Clear Language on How Maintenance Reserve Funds Will Be Established to Address Expected and Unexpected Maintenance Needs.

Issue Summary

Under Code, the Commission has a duty to ensure that its institutions generate and set aside adequate funds to maintain their properties and reduce the accumulated deferred maintenance. These institutions are to calculate necessary maintenance amounts according to a building renewal funding formula established by the Commission in the System Capital Development Plan. However, as Issue 1 of this report indicates, the Plan has not been completed. In the absence of the completed Plan to generate maintenance reserve funds, the Commission has put into effect a 10-percent reserve fund be retained from project revenues or bond funds. However, the language defining the 10-percent reserve fund will not accomplish the intent of West Virginia Code §18B-19-5(c)(4) because the Commission describes it as a guideline, not a requirement. Moreover, the Commission's rule also states that this reserve fund is to be used for debt service, rather than for maintenance. Although the Commission has a statutory duty to ensure that funds are being collected and applied to reducing the accumulation of deferred maintenance, the Commission has not made it clear in its rules how it is complying with this duty. In addition, the Commission and its institutions, with the exception of Marshall and West Virginia University (WVU), lack of a policy to address maintenance funding for projects built with private and mixed funding which is contrary to legislative intent.

Under Code, the Commission has a duty to ensure that its institutions generate and set aside adequate funds to maintain their properties and reduce the accumulated deferred maintenance.

Although the Commission has a statutory duty to ensure that funds are being collected and applied to reducing the accumulation of deferred maintenance, the Commission has not made it clear in its rules how it is complying with this duty.

The Commission's 10 Percent Reserve Fund Is a Guideline and It Does Not Specify the Use Is for Maintenance

West Virginia's public institutions must strive to provide quality facilities for students and staff. Given the deferred maintenance backlog, the Legislature saw the importance of institutions developing funding mechanisms to address the maintenance needs of their facilities. The recent study completed by Sightlines estimated the total deferred maintenance backlog of the Commission's institutions at over $1.2 billion. It should be noted that the Commission did not include the West Virginia University Institute of Technology's deferred maintenance as part of the total backlog since the institution is transferring its programs to Beckley in 2017. Therefore, the facilities in Montgomery will no longer be in use and not counted as deferred maintenance. Table 1 shows a breakdown of deferred maintenance by institution. Consequently, legislation was passed in 2010 through W. Va. §18B-19-5(c)(4) which states that

> *"The commission shall work with institutions under its jurisdiction to ensure that adequate funds are generated to fund maintenance and build adequate reserves from educational and general and auxiliary capital fees and other revenue consistent with the building renewal formula. The Legislature recognizes that it may take several years for this to be accomplished fully."*

The building renewal formula identified in this mandate is part of the System Capital Development Plan, addressed in Issue 1 of this report, which has yet to be completed. Therefore, the Commission is unable to carry out this mandate until the Plan is completed. The Legislative Auditor concludes that the Commission has not made accomplishing this mandate a priority.

The Commission stated that it has established a policy through its CSR §133-12 that a project should have a reserve fund equal to approximately 10 percent of its cost. This reserve fund is to be funded by the project's annual revenue and/or bond proceeds. The Commission indicated that the policy is a guideline, not a requirement.

Table 1
Deferred Maintenance Backlog by Institution

Institution	Deferred Maintenance Backlog
Bluefield State College	36,000,000
Concord University	64,000,000
Fairmont State University	86,000,000
Glenville State College	57,000,000
Marshall University	184,000,000
Potomac State College	29,000,000
Shepherd University	74,000,000
West Liberty University	67,000,000
West Virginia School of Osteopathic Medicine	38,000,000
West Virginia State University	95,000,000
West Virginia University	499,000,000
TOTAL	**1,229,000,000**

(Unaudited by the Legislative Auditor)
Source: Higher Education Policy Commission, Sightlines 2014 Facilities Management Study.

The language addressing the 10 percent reserve fund does not mention maintenance as the use of the fund and the rule's definition of reserve fund indicates the purpose is for debt service.

The Commission stated that it has established a policy through its CSR §133-12 that a project should have a reserve fund equal to approximately 10 percent of its cost. This reserve fund is to be funded by the project's annual revenue and/or bond proceeds. The Commission indicated that the policy is a guideline, not a requirement. Furthermore, the language addressing the 10 percent reserve fund does not mention maintenance as the use of the fund and the rule's definition of reserve fund indicates the purpose is for debt service. The Legislative Auditor concludes that the Commission's rules do not establish a requirement for a maintenance reserve fund that is consistent with the shall provision of W. Va. §18B-19-5(c)(4). **Therefore, the Legislative Auditor recommends**

the Commission clarify language in its rule to establish and require a reserve fund for maintenance.

Most Institutions Do Not Have a Reserve Funding Policy for Privately and Mixed-Funded Projects for Facility Maintenance

The Commission stated that it does not have any policy addressing maintenance funding requirements for privately and mixed-funded projects.

The Commission stated that it does not have any policy addressing maintenance funding requirements for privately and mixed-funded projects. In lieu of the Commission not having such policies, the audit team asked the institutions what policies, if any, they have that require reserve maintenance funds for the privately and mixed-funded projects in the absence of Commission policies. A summary of results is presented in Table 2.

Table 2
Summary of Institutional Privately-Funded/Mixed Funding Maintenance Funding Survey Results

Institution	Privately and Mixed-Funded Project Funding Policy?	Number of Privately and Mixed-Funded Projects in the Past Five Years
Bluefield State	No	None
Concord	No	None
Fairmont State	No	None
Glenville State	No	2
Marshall	Yes	5 or more
Shepherd	No	None
West Liberty	No	5 or more
West Virginia University	Yes	4
West Virginia State	No	2

Source: *PERD survey of Commission institutions.*

The audit team learned that of the nine institutions under the Commission's authority, only two institutions, Marshall University and WVU, maintained frameworks for reserve maintenance funding for privately and mixed-funded projects.

The audit team learned that of the nine institutions under the Commission's authority, only two institutions, Marshall University and WVU, maintained frameworks for reserve maintenance funding for privately and mixed-funded projects. Both institutions acquire maintenance funding through different mechanisms.

Marshall and West Virginia Universities Have Policies to Address Maintenance Funding for Privately and Mixed-Funded Projects

In an information request response provided to the audit team, Marshall University noted that facilities constructed through public/private partnerships accrue maintenance funds through revenue streams the building provides, such as housing and recreation center fees. They further stated that maintenance expenditures are built into the annual operating budget and a contingency fund. The contingency fund is available for larger needs that occur periodically. Marshall University indicated that the source of funding for a project does not dictate the maintenance funding; however, when bond funding is involved, it has some influence in requiring funds to be set aside for maintenance.

Marshall University noted that facilities constructed through public/private partnerships accrue maintenance funds through revenue streams the building provides, such as housing and recreation center fees.

Marshall University's revenue bonds are paid through revenues from housing operations, parking operations, and capital fees charged to students. Revenue from housing and parking operations are used to pay the operating expenses of those facilities and the debt service of older revenue bonds; reserves exist for operations, debt service, and renewal and replacement related to these facilities out of the remaining net revenue. Operating budgets for housing and parking facilities provide funding for routine maintenance and minor repair and renovation projects within their facilities. Any capital fees charged to Marshall University students must first pay for Commission bond obligations and are then available to pay for debt service for the institution's most recent revenue bonds.

WVU takes a different approach to maintenance funding. In its survey response, WVU stated that it maintains contractual provisions with its private sector partners for public/private agreements. These contracts require projects to maintain capital, operating budgets, and a capital reserve account as a source of funding for routine and non-routine maintenance. Although not a formal institutional policy, WVU stated that binding contracts with its private sector partners offers greater discipline and structure to meet maintenance and capital needs.

WVU stated that it maintains contractual provisions with its private sector partners for public/private agreements. These contracts require projects to maintain capital, operating budgets, and a capital reserve account as a source of funding for routine and non-routine maintenance.

As an example of a contractual agreement, WVU provided a copy of the contract between WVU and American Campus Communities (ACC), a Delaware limited liability company, for the College Park Apartments located on the institution's Morgantown campus. The audit team verified that the contract contained requirements for facility maintenance and furniture, fixtures, and equipment. Specifically, the contract outlines that ACC will provide maintenance for "back of the house" areas, HVAC serving the project, fire and life safety, and plumbing and other building systems. The contract further states that, "in consideration for performing all of ACC's services under this Agreement," ACC will be entitled to payment equal to two percent of the gross revenues per operating year.

The Commission's Smaller Institutions Are at Greater Risk of Having Increased Pressure on Maintenance Budgets

Four of the Commission's smaller institutions commented in PERD's survey that they have limited financial resources to address maintenance issues at their campuses. Two of these four institutions noted a decrease in state financial support as a reason.

West Liberty University best illustrates this problem. This institution has completed five or more privately-funded or mixed-funded projects in the past five years. The buildings' future maintenance spending is to be drawn from the institution's current maintenance budget.

West Liberty University best illustrates this problem. This institution has completed five or more privately-funded or mixed-funded projects in the past five years. The buildings' future maintenance spending is to be drawn from the institution's current maintenance budget. In addition, West Liberty stated that many of its other facilities are old and that "budget constraints make it difficult to keep up with maintenance." While other institutions may not face as serious a situation, the Legislative Auditor concludes that a policy requiring maintenance reserve funds for projects, including privately-funded and mixed-funded projects, would ensure sufficient funding for maintenance and not add financial pressure to institutions' existing maintenance budgets. **Therefore, the Legislative Auditor recommends that the Commission adopt a policy dictating that privately-funded and mixed-funded construction projects have sufficient funds set aside for maintenance spending.**

The Legislative Auditor concludes that the Commission needs to specifically address establishing a mandatory maintenance funding policy, as well as extending the policy to privately and mixed-funded projects.

Conclusion

The Legislature identified the need that all projects are built with some funding set aside for future maintenance when it enacted W. Va. §18B-19-5(c)(4). Language in the Commission's rules does not specifically address a mandatory reserve fund for maintenance. The Commission and all but two of its institutions do not have a maintenance funding policy for privately and mixed-funded projects. The Legislative Auditor concludes that the Commission needs to specifically address establishing a mandatory maintenance funding policy, as well as extending the policy to privately and mixed-funded projects. If no action is taken, the Legislative Auditor is concerned that new, privately and mixed-funded construction projects will increase financial pressure on institutions' existing maintenance budgets and increase the deferred maintenance backlog of the Commission's institutions. Another concern is that increased maintenance costs will continue to be passed on to students, thereby further increasing the cost to attend college, which counters the goals of the Legislature when it mandated the Commission to develop the System Capital Development Plan in 2010.

Another concern is that increased maintenance costs will continue to be passed on to students, thereby further increasing the cost to attend college, which counters the goals of the Legislature when it mandated the Commission to develop the System Capital Development Plan in 2010.

Recommendations

2. *The Legislative Auditor recommends the Commission clarify language in its rule to establish and require a reserve fund for maintenance.*

3. *The Legislative Auditor recommends that the Commission adopt a policy to ensure that institutional privately-funded and mixed-funded construction projects have sufficient funds set aside for future maintenance spending.*

Appendix A
Transmittal Letter

WEST VIRGINIA LEGISLATURE

Performance Evaluation and Research Division

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX

John Sylvia
Director

February, 12, 2016

Mr. Paul Hill, Chancellor
Higher Education Policy Commission
1018 Kanawha Boulevard, East - Suite 700
Charleston, WV 25301

Dear Chancellor Hill:

This is to transmit a draft copy of the Agency Review of the Higher Education Policy Commission. This report may be scheduled to be presented during the regular session at a meeting of the Joint Standing Committee on Government Organization. We will inform you of the exact time and location once the information becomes available. It is expected that a representative from your agency be present at the meeting to orally respond to the report and answer any questions committee members may have during or after the meeting.

We need to schedule an exit conference to discuss any concerns you may have with the report. We would like to meet on Thursday, February 18, 2016. Please notify us to schedule an exact time.

We request that your personnel not disclose the report to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

John Sylvia

John Sylvia

Enclosure

Joint Committee on Government and Finance

Appendix B
Objectives, Scope and Methodogly

The Performance Evaluation and Research Division (PERD) within the Office of the Legislative Auditor conducted this agency review of the West Virginia Higher Education Policy Commission (Commission) as required and authorized by the West Virginia Performance Act, Chapter 4, Article 10, of the West Virginia Code as amended. The purposes of the Commission, as established in W. Va. §18B-1B-1, are to be responsible to develop, gain consensus around and oversee the public policy agenda for higher education.

Objective

The objective of this audit is to determine to what extent the Higher Education Policy Commission provides oversight for the development and maintenance of institutional facilities as required by W. Va. §18B-19.

Scope

The scope of this audit is limited to the Commission's oversight responsibilities concerning facility development and maintenance at its institutions from fiscal years 2010 through 2015. In terms of facility development, the audit specifically assessed the status of the System Capital Development Plan (Plan) and the Higher Education Facilities Information System (HEFIS). Regarding maintenance, the audit assessed the Commission's compliance with W. Va. §18B-19-5(c)(4), which calls for the Commission to work with its institutions to ensure that adequate funds are generated to fund maintenance.

Methodology

PERD gathered and analyzed several sources of information and conducted audit procedures to assess the sufficiency and appropriateness of the information used as audit evidence. Testimonial evidence was gathered through interviews with the Commission's staff. The purpose for testimonial evidence was to gain a better understanding or clarification of certain issues, to confirm the existence or non-existence of a condition, or to understand the Commission's position on an issue. Such testimonial evidence was confirmed by written statements.

PERD reviewed W. Va. §18B-19 and determined that the Plan and HEFIS were central to the Commission's overarching goals. The audit team then asked for status updates for both the Plan and HEFIS. After learning that neither of these mechanisms were completed, the audit team asked the Commission to provide documentation supporting its reasons for their delay. PERD acquired the general revenue budget data for the Commission from fiscal years 2010 to 2015 to evaluate the agency's reasons for the delay of the Plan and HEFIS.

PERD asked the Commission to provide documentation identifying what actions it has taken to ensure the provisions of W. Va. §18B-19-5(c)(4), which speaks to facility maintenance. The audit team collected documentary evidence to confirm this claim. PERD asked the Commission to provide any policies it has that address requiring funding reserves for maintenance. PERD conducted a survey of chief financial officers at each of the Commission's institutions. The purpose of this survey was to determine the existence of maintenance policies, the extent of the Commissions involvement in relation to maintenance oversight, and recent capital development. The institutions provided documentation to support the existence of maintenance policies.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix C
Agency Response

Bruce L. Berry, M.D.
Chair

Paul L. Hill, Ph.D.
Chancellor

Leading the Way: *Access. Success. Impact.*

West Virginia Higher Education Policy Commission
1018 Kanawha Boulevard, East, Suite 700
Charleston, West Virginia 25301
www.hepc.wvnet.edu

February 23, 2016

PERFORMANCE EVALUATION
FEB 24 2016
AND RESEARCH DIVISION

Mr. John Sylvia
Director
Performance Evaluation and Research Division
West Virginia Legislature
Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305

Dear Mr. Sylvia:

Thank you for the opportunity to discuss with you and your team in an exit conference a draft copy of the Agency Review of the West Virginia Higher Education Policy Commission (Commission) provided to us on February 12, 2016. This letter is to share with you on record our agency response to your team's findings.

We address specific items below each of your audit conclusions; however, we also wish to state that, in general, the Commission believes it has worked within its budgetary and timeframe limitations with the Legislature to meet the requirements of State Code.

In recent years, the Legislature appropriately put in place a number of measures designed to ensure that our colleges and universities have a plan to address deferred maintenance. The problem is that there has been no additional funding to support the level of deferred maintenance required, and continued reduced state funding of our institutions should have, and indeed has, required a different approach to capital development.

Of particular note is the passage of the amended Title 133, Series 12, Legislative Rule, Capital Project Management, approved by the Commission in 2014 and approved by the Legislature in 2015. The original, former version of Series 12, promulgated in 2000 and revised in 2001, was repealed and replaced by the current legislative rule which became effective April 30, 2015. The legislative rule is the foundation of the System Capital Development Plan, and it allowed for almost a year to complete the plan after its *intended* approval during the 2014 legislative session. It was not approved until 2015, so the plan implementation is mostly on time, given the approval of the capital development rules.

CHANCELLOR'S OFFICE
(304) 558-0699 *phone* • (304) 558-1011 *fax*

Page 2

Regarding implementation of the plan, we agree with the auditor's findings that these items should have a high priority. Indeed, with the implementation of the Sightlines report and passage of our capital project management rule, we believe we are well on the road to ensuring implementation of the System Capital Development Plan. It will remain a priority of the Commission.

Sincerely,

Paul L. Hill
Chancellor

Page 3

Issue 1: The Higher Education Policy Commission Has Yet to Complete the System Capital Development Plan or the Higher Education Facilities Information System as Required by West Virginia Code §18B-19-3.

Issue Summary

During the 2010 legislative session, the Legislature mandated that the Higher Education Policy Commission (Commission) develop a System Capitol Development Plan (Plan) by December 31, 2011 for approval by the Legislative Oversight Commission on Education Accountability. The Plan is intended to address the deferred maintenance at higher education institutions. More than four years after the deadline, the Commission is still in the process of completing the Plan. The Commission was able to amend the deadline to December 31, 2014 when its legislative rule was approved by the Legislature in 2015. The Commission has contracted with a firm to study capital development needs of all higher education institutions. The Commission plans to submit a draft of the Plan at its March 2016 meeting.

However, the Commission was also required to develop and maintain a Higher Education Facilities Information System (HEFIS) that would serve several functions, one of which is to provide needed data on facilities to calculate the Plan's renewal formula. The renewal formula would indicate the amount to be invested in facilities to minimize deferred maintenance. Although the Commission is working on developing HEFIS, no timeframe has been given on when HEFIS will be completed.

The Commission explained that the reasons for the delay in completing the Plan and HEFIS are recent budget cuts and the need to take a more strategic approach to funding facility maintenance. It is difficult for the Legislative Auditor to justify the Commission's explanations since the referenced budget cuts occurred years after the December 31, 2011 deadline. Given the importance of the statutorily-mandated projects in addressing the deferred maintenance of higher education institutions, the Legislative Auditor recommends that the Commission give these issues greater priority.

West Virginia Code Requires the Completion of a System Capitol Development Plan

West Virginia Code §18B-19-3 mandates the Higher Education Policy Commission to develop a System Capital Development Plan for approval by the Legislative Oversight Commission on Education Accountability (LOCEA) by December 31, 2011. The purpose of the Plan is to address capital improvements and facility maintenance needs at West Virginia's colleges and universities and reduce the obligation of students and parents to bear the cost of higher education capital projects and facilities maintenance. West Virginia Code §18B-19-3 outlines the development and implementation of the Plan. The statute states that at a minimum the Plan shall include the following:

(1) System goals for capital development;

Page 4

(2) An explanation of how system capital development goals align with state goals, objectives and priorities established in articles one and one-d of this chapter and with system master plans;

(3) A process for prioritizing capital projects for state funding based on their ability to further state goals, objectives and priorities and system capital development goals;

(4) A building renewal formula to calculate a dollar benchmark that shall be collected annually and invested in facilities to minimize deferred maintenance and to provide the commission and council objective information to determine if the investments in maintenance are occurring;

(5) A process for governing boards to follow in developing and submitting campus development plans to the commission or council, as appropriate, for approval;

(6) A process for governing boards to follow to ensure that sufficient revenue is generated for and applied toward facilities maintenance;

(7) A discussion addressing how capital fees dedicated to debt service for the bond issue to be paid off in 2012 will be used after the payoff date.

The Commission Has Yet to Complete a System Capital Development Plan

More than four years have transpired since the December 31, 2011 deadline, yet the Plan has not been completed. The Commission provided two reasons why it was unable to meet the initial deadline. First, according to the Commission, economic conditions since 2010 made it difficult to address the Plan's development. The Commission stated that reductions in general revenue budgets over the past three years hindered it from addressing this statute in a robust fashion.

Second, given changes in the economic environment, the Commission stated it was necessary to develop a "strategic approach" to funding options. When asked to elaborate on the term "strategic approach," the Commission responded that relying on student fees and state funding are unstable funding strategies in the future. Therefore, it was important to develop spending strategies that accounted for decreased funding. In order to develop this approach, the Commission found "it was necessary to acquire an understanding of the current deferred maintenance backlog, projected funding requirements, and facility utilization rates." According to the Commission, it started this strategic approach in 2010 with work on Legislative Rule, Series 12, Capital Project Management. The Commission approved this rule on December 6, 2013, and the Legislature approved it during the 2015 regular session. This rule outlines the structure of the System Capital Development Plan, including the data elements for both the building renewal formula and for HEFIS as well as extend the Plan's deadline to December 31, 2014.

The Legislative Auditor has concerns with the Commission's reasons for not completing the Plan in a timely manner. First, the budget cuts the Commission refers to did not take place until after the December 31, 2011 deadline. There were two 7.5 percent budget cuts, one in FY 2014 and

Page 5

the other in 2015, and a 4 percent cut for FY 2016. **There appears to have been a low priority for completing this mandate.**

The Recent Facilities Management Reports Completed by Sightlines Lays the Groundwork for Completing the Plan

The Commission contracted Sightlines LLC to assist in developing the Plan. The Commission's contract with Sightlines started on July 1, 2014. Per a change order authorized on August 21, 2015, the contract is ongoing until June 30, 2016 and the final cost will total $709,260. Sightlines provided the Commission with individual reports on all nine institutions under its purview, as well as the West Virginia School of Osteopathic Medicine. These reports looked at numerous issues pertaining to facility management, comparing institutions to public institutions in other states, building life-cycles, risk level for campus buildings, student density, funding sources, spending trends, operational effectiveness, maintenance backlogs, and strategies for long-term success. The Sightlines study provides the Commission with a benchmark inventory of total deferred maintenance as of 2014. It is estimated that the total amount of deferred maintenance at the Commission's institutions is $1.2 billion. The report issued in April 2015 had numerous conclusions, one of which is that an additional $50 million of annual spending is needed to address the system-wide deferred maintenance. This annual investment would eliminate the current deferred maintenance over 24 years.

The Commission indicated that the Plan will be reviewed by campus facility administrators and chief financial officers before being submitted at a March 2016 meeting. However, the Commission did not provide a timeframe beyond this meeting. The audit team concludes that, although incomplete, the Commission has made recent progress in the Plan's development. Timely introduction of the System Capital Development Plan will allow the State, Commission, and institutions to address the issues identified in the Sightlines analysis. **Therefore, the Legislative Auditor recommends that the Commission give priority to the completion of the Plan.**

The Commission Has Yet to Develop and Implement the Higher Education Facilities Information System.

Although development of the Plan is progressing, implementing the Plan will depend on the development of a facilities information system. Therefore, the Legislature, in the same 2010 legislation, required the Commission to develop and maintain the Higher Education Facilities Information System (HEFIS), which would generate facilities data for the building renewal formula of the Plan. The formula would incorporate the data and identify the maintenance funds needed for each institution. However, the Commission has not completed the HEFIS component of the Plan.

PERD asked the Commission what is the status of the HEFIS project? The agency responded:

> *The HEFIS is currently in development. The data elements for the system are being defined. The West Virginia Board of Risk Insurance Management (BRIM) has provided a file containing many of the system's data elements and the selected elements will be used to support strategic decisions at the institution and*

Page 6

Commission/Council levels.

In another information request response related to the HEFIS, the Commission stated that the database system will be cloud-based and will have the capacity to import data elements from existing information systems, such as Banner and BRIM. Since the Code of State Rules §133-12-10, which defines HEFIS's data elements, was not in place and approved by the Legislature until the 2015 Regular Session, the Commission concluded that it would not have been prudent to move forward with designing the new database.

Delays in completing the database will prevent the implementation of the System Capital Development Plan's building renewal formula, since the formula is reliant on data from HEFIS. Moreover, the Commission has not stated a timeframe on when HEFIS will be completed. **Therefore, the Legislative Auditor recommends that the Commission give greater priority to completing and implementing this database.**

Conclusion

The System Capital Development Plan, which was mandated by the Legislature to be completed by December 31, 2011, is now more than four years overdue. However, there is no definite completion date set for when the HEFIS component of the Plan will be completed. Without HEFIS, the Plan will be ineffective. The reasons given by the Commission for not completing the Plan and HEFIS in a timely manner are not compelling for not meeting the original deadline. The Legislative Auditor determines that a lack of priority is the logical conclusion. The Commission was unable to comply with the 2011 deadline, however, it was able to have legislative rules passed that extended the Plan's deadline to December 31, 2014. The Commission has made progress in completing the Plan and has scheduled to have it presented at the Commission's March 2016 meeting. The timely implementation of the Plan and HEFIS are critical for the Commission to achieve its goals related to improving and maintaining the state's higher education institutions. Failure to develop the Plan prevents the Commission from carrying out its other statutory duties that flow from the Plan.

Recommendation

1. *The Legislative Auditor recommends that the Higher Education Policy Commission give greater priority to completing the System Capital Development Plan, and the Higher Education Facilities Information System.*

Commission Response: The Commission concurs with the auditor that the System Capital Development Plan should be a top priority. The plan is on a steady track to completion and will remain a priority. As a matter of background concerning any delay in completing it to this point, according to Title 133, Series 12, Legislative Rule, Capital Project Management, the legislative rule approved by the Commission and submitted to the Legislature for approval during the 2014 session, the rule states, "By December 31, 2014, the Commission and Council shall, jointly or separately, develop a system capital development plan for approval by the Legislative Oversight Commission on Education Accountability."

Page 7

This rule is the foundation of the System Capital Development Plan. The rule allowed for almost a year to complete the plan after its intended approval during the 2014 legislative session.

In addition to the newer timeframe established through the aforementioned rule, the state's economic climate has significantly worsened since the associated legislation was passed in 2011. This downturn in the economy and subsequent funding reductions to our institutions necessitated additional time by the Commission to assess the status of the institutions' facilities and to develop a plan that includes multiple, strategies to address the deferred maintenance backlog.

In the interim, the Commission has requested $10 million annually under West Virginia Code §18B-19-5 to address the most pressing and immediate deferred maintenance needs at our institutions. Of the $50 million requested since 2012, the Legislature has appropriated zero dollars to date.

The development of the HEFIS system depends upon the information needs described in the System Capital Development Plan. Consequently, it would not have been practical to create the system until the data elements were defined by the plan. Upon approval of the plan, the HEFIS system will be created and the data fields will be populated.

The estimated annual cost to fund the cloud-based HEFIS system is about $30,000 per year. The Commission anticipates it can begin uploading data to this system before the end of this calendar year.

Issue 2: The Commission's Rules Do Not Have Clear Language on How Maintenance Reserve Funds Will be Established to Address Expected and Unexpected Maintenance Needs.

Issue Summary

Under Code, the Commission has a duty to ensure that its institutions generate and set aside adequate funds to maintain their properties and reduce the accumulated deferred maintenance. These institutions are to calculate necessary maintenance amounts according to a building renewal funding formula established by the Commission in the System Capital Development Plan. However, as Issue 1 of this report indicates, the Plan has not been completed. In the absence of the completed Plan to generate maintenance reserve funds, the Commission has put into effect a 10-percent reserve fund be retained from project revenues or bond funds. However, the language defining the 10-percent reserve fund will not accomplish the intent of West Virginia Code §18B-19-5(c)(4) because the Commission describes it as a guideline, not a requirement. Moreover, the Commission's rule also states that this reserve fund is to be used for debt service, rather than for maintenance. Although the Commission has a statutory duty to ensure that funds are being collected and applied to reducing the accumulation of deferred maintenance, the Commission has not made it clear in its rules how it is complying with this duty. In addition, the Commission and its institutions, with the exception of Marshall and West Virginia University (WVU), lack of a policy to address maintenance funding for projects built with private and mixed funding which is contrary

Page 8

to legislative intent.

The Commission's 10 Percent Reserve Fund Is a Guideline and It Does Not Specify the Use Is for Maintenance

West Virginia's public institutions must strive to provide quality facilities for students and staff. Given the deferred maintenance backlog, the Legislature saw the importance of institutions developing funding mechanisms to address the maintenance needs of their facilities. The recent study completed by Sightlines estimated the total deferred maintenance backlog of the Commission's institutions at over $1.2 billion. It should be noted that the Commission did not include the West Virginia University Institute of Technology's deferred maintenance as part of the total backlog since the institution is transferring its programs to Beckley in 2017. Therefore, the facilities in Montgomery will no longer be in use and not counted as deferred maintenance. Table 1 shows a breakdown of deferred maintenance by institution. Consequently, legislation was passed in 2010 through W.Va. Code §18B-19-5(c)(4) which states that "*The commission shall work with institutions under its jurisdiction to ensure that adequate funds are generated to fund maintenance and build adequate reserves from educational and general and auxiliary capital fees and other revenue consistent with the building renewal formula. The Legislature recognizes that it may take several years for this to be accomplished fully.*" The building renewal formula identified in this mandate is part of the System Capital Development Plan, addressed in Issue 1 of this report, which has yet to be completed. Therefore, the Commission is unable to carry out this mandate until the Plan is completed. The Legislative Auditor concludes that the Commission has not made accomplishing this mandate a priority.

Table 1
Deferred Maintenance Backlog by Institution

Institution	Deferred Maintenance Backlog
Bluefield State College	36,000,000
Concord University	64,000,000
Fairmont State University	86,000,000
Glenville State College	57,000,000
Marshall University	184,000,000
Potomac State College	29,000,000
Shepherd University	74,000,000
West Liberty University	67,000,000
West Virginia School of Osteopathic Medicine	38,000,000
West Virginia State University	95,000,000
West Virginia University	499,000,000
TOTAL	**1,229,000,000**

(Unaudited by the Legislative Auditor)
Source: Higher Education Policy Commission, Sightlines 2014 Facilities Management Study.

Page 9

The Commission stated that it has established a policy through its Code of State Rules §133-12 that a project should have a reserve fund equal to approximately 10 percent of its cost. This reserve fund is to be funded by the project's annual revenue and/or bond proceeds. The Commission indicated that the policy is a guideline, not a requirement. Furthermore, the language addressing the 10 percent reserve fund does not mention maintenance as the use of the fund and the rule's definition of reserve fund indicates the purpose is for debt service. The Legislative Auditor concludes that the Commission's rules do not establish a requirement for a maintenance reserve fund that is consistent with the shall provision of W. Va. Code §18B-19-5(c)(4). **Therefore, the Legislative Auditor recommends the Commission clarify language in its rule to establish and require a reserve fund for maintenance.**

Most Institutions Do Not Have a Reserve Funding Policy for Privately and Mixed-Funded Projects for Facility Maintenance

The Commission stated that it does not have any policy addressing maintenance funding requirements for privately and mixed-funded projects. In lieu of the Commission not having such policies, the audit team asked the institutions what policies, if any, they have that require reserve maintenance funds for the privately and mixed-funded projects in the absence of Commission policies. A summary of results is presented in Table 2.

Table 2
Summary of Institutional Privately-Funded/Mixed Funding Maintenance Funding Survey Results

Institution	Privately and Mixed-Funded Project Funding Policy?	Number of Privately and Mixed-Funded Projects in the Past Five Years
Bluefield State	No	None
Concord	No	None
Fairmont State	No	None
Glenville State	No	2
Marshall	Yes	5 or more
Shepherd	No	None
West Liberty	No	5 or more
West Virginia University	Yes	4
West Virginia State	No	2

Source: PERD survey of Commission institutions.

The audit team learned that of the nine institutions under the Commission's authority, only two institutions, Marshall University and WVU, maintained frameworks for reserve maintenance funding for privately and mixed-funded projects. Both institutions acquire maintenance funding through different mechanisms.

Page 10

Marshall and West Virginia Universities Have Policies to Address Maintenance Funding for Privately and Mixed-Funded Projects

In an information request response provided to the audit team, Marshall University noted that facilities constructed through public/private partnerships accrue maintenance funds through revenue streams the building provides, such as housing and recreation center fees. They further stated that maintenance expenditures are built into the annual operating budget and a contingency fund. The contingency fund is available for larger needs that occur periodically. Marshall University indicated that the source of funding for a project does not dictate the maintenance funding; however, when bond funding is involved, it has some influence in requiring funds to be set aside for maintenance.

Marshall University's revenue bonds are paid through revenues from housing operations, parking operations, and capital fees charged to students. Revenue from housing and parking operations are used to pay the operating expenses of those facilities and the debt service of older revenue bonds; reserves exist for operations, debt service, and renewal and replacement related to these facilities out of the remaining net revenue. Operating budgets for housing and parking facilities provide funding for routine maintenance and minor repair and renovation projects within their facilities. Any capital fees charged to Marshall University students must first pay for Commission bond obligations and are then available to pay for debt service for the institution's most recent revenue bonds.

WVU takes a different approach to maintenance funding. In its survey response, WVU stated that it maintains contractual provisions with its private sector partners for public/private agreements. These contracts require projects to maintain capital, operating budgets, and a capital reserve account as a source of funding for routine and non-routine maintenance. Although not a formal institutional policy, WVU stated that binding contracts with its private sector partners offers greater discipline and structure to meet maintenance and capital needs.

As an example of a contractual agreement, WVU provided a copy of the contract between WVU and American Campus Communities (ACC), a Delaware limited liability company, for the College Park Apartments located on the institution's Morgantown campus. The audit team verified that the contract contained requirements for facility maintenance and furniture, fixtures, and equipment. Specifically, the contract outlines that ACC will provide maintenance for "back of the house" areas, HVAC serving the project, fire and life safety, and plumbing and other building systems. The contract further states that, "in consideration for performing all of ACC's services under this Agreement," ACC will be entitled to payment equal to two percent of the gross revenues per operating year.

The Commission's Smaller Institutions Are at Greater Risk of Having Increased Pressure on Maintenance Budgets

Four of the Commission's smaller institutions commented in PERD's survey that they have limited financial resources to address maintenance issues at their campuses. Two of these four

Page 11

institutions noted a decrease in state financial support as a reason.

West Liberty University best illustrates this problem. This institution has completed five or more privately-funded or mixed-funded projects in the past five years. The buildings' future maintenance spending is to be drawn from the institution's current maintenance budget. In addition, West Liberty stated that many of its other facilities are old and that "budget constraints make it difficult to keep up with maintenance." While other institutions may not face as serious a situation, the Legislative Auditor concludes that a policy requiring maintenance reserve funds for projects, including privately-funded and mixed-funded projects, would ensure sufficient funding for maintenance and not add financial pressure to institutions' existing maintenance budgets. **Therefore, the Legislative Auditor recommends that the Commission adopt a policy dictating that privately-funded and mixed-funded construction projects have sufficient funds set aside for maintenance spending.**

Conclusion

The Legislature identified the need that all projects are built with some funding set aside for future maintenance when it enacted W.Va. Code §18B-19-5(c)(4). Language in the Commission's rules does not specifically address a mandatory reserve fund for maintenance. The Commission and all but two of its institutions do not have a maintenance funding policy for privately and mixed-funded projects. The Legislative Auditor concludes that the Commission needs to specifically address establishing a mandatory maintenance funding policy, as well as extending the policy to privately and mixed-funded projects. If no action is taken, the Legislative Auditor is concerned that new, privately and mixed-funded construction projects will increase financial pressure on institutions' existing maintenance budgets and increase the deferred maintenance backlog of the Commission's institutions. Another concern is that increased maintenance costs will continue to be passed on to students, thereby further increasing the cost to attend college, which counters the goals of the Legislature when it mandated the Commission to develop the System Capital Development Plan in 2010.

Recommendations

2. *The Legislative Auditor recommends the Commission clarify language in its rule to establish and require a reserve fund for maintenance.*

3. *The Legislative Auditor recommends that the Commission adopt a policy to ensure that institutional privately-funded and mixed-funded construction projects have sufficient funds set aside for future maintenance spending.*

Commission Response: Reserve funds are addressed in Title 133, Series 12, Legislative Rule, Capital Project Management. The Commission agrees that institutions must have sufficient reserves for unexpected events that may develop that would affect operations and facilities. The Commission annually provides institutions with Composite Financial Index (CFI) data and other information to determine the adequacy of their reserves. The CFI is also used by the Higher Learning Commission

Page 12

to assess the financial health of the colleges and universities that it accredits.

The Commission's capital rule requires institutions to determine the effect new projects would have on their future CFI. The Commission uses the 10 percent amount as a guideline because it would not be prudent to require a single reserve percentage requirement for all institutions because their characteristics and the microeconomic circumstances that they face vary considerably from institution to institution.

Public colleges and universities are atypical state agencies because the receipt of most of their revenues depends upon the choices of individuals, who can choose which organization best serves their needs. As a result, the financial health of a college or university is directly related to their ability to respond to those needs. The ability to build reserves and the appropriateness of their size depends to a great extent upon an institution's competitive market position.

An institution that has not been responsive to students' needs (its market), may have allowed buildings to deteriorate. If students have decided to enroll at other colleges or universities in response, the institution's financial health will decline. If the institution is required by the Commission to set its maintenance reserves at a specific level, it may be prevented from completing the necessary renovations to reverse its enrollment decline. The risks it faces from continued enrollment declines may be greater than the risks it faces from an unexpected facility problem if the local governing board is cognizant of these risks and works with institutional leadership to rectify the problem.

As an example, another institution could have enjoyed strong financial health and the ability to adequately finance its facilities' needs. It also has strong facilities management in place. Because its facilities are relatively new and well-managed, this institution may not need to maintain the same level of reserves an institutions that is not as strong.

Sufficient capital reserves may be accumulated when institutions improve their financial health. The structure of the system capital development plan provides a path to achieve this improvement as it recognizes the level of future state funding will be uncertain. An institution's financial health will improve as it focuses its resources on its mission; improves its responsiveness to student needs; operates closely to full physical capacity; and increases its operational efficiency, again, if institutional boards are meeting their fiduciary responsibilities defined by code.

The West Virginia Code recognizes the accumulation of sufficient reserves may take time. Although the building of reserves in the face of an overall $1.2 billion deferred backlog and an annual expenditure of $50 million to address deferred maintenance appears to be an overwhelming task, the Commission's approach will lead to improved financial strength and higher reserves.

The Commission believes that its approach to assess each institution's reserves on an annual basis and work with the colleges and universities to improve their financial health will fulfill the requirements of the Code to increase reserves.

The funding of a deferred maintenance reserve for any privately or mixed-funded project is

Page 13

certainly a desirable goal. However, the requirement that such reserves be funded may not always be in the best interests of the institution or the state. If a donor is willing to finance a reserve, the gift should be accepted.

If private or mixed-funding was received for a project that did not align with the approach defined in the System Capital Development Plan, the funding of a deferred maintenance reserve would offset future costs. For such a project, no additional net revenues will accrue from the use of the building; it would not improve the capacity utilization rate; and operating costs per unit would increase. The institution and the Commission would need to question the need for such a building, given its negative impact.

On the other hand, if an institution receives private or mixed-funding for a project that increases net revenues; improves the campus facility utilization rate or maintains an existing high utilization rate; and reduces operating costs per unit, the best course of action may be to accept private or mixed-funds for the construction of a structure *without* the financing of a reserve for future deferred maintenance needs.

If a reserve is not established at the time private or mixed-funds are provided, the institutions' progress towards the accumulation of adequate facility reserves must not be hindered by the new construction. Often private and mixed-funding can be used to replace existing facilities that are a substantial portion of an institutions' deferred maintenance backlog.

WEST VIRGINIA LEGISLATIVE AUDITOR
PERFORMANCE EVALUATION & RESEARCH DIVISION

Building 1, Room W-314, State Capitol Complex, Charleston, West Virginia 25305

telephone: 1-304-347-4890 | www.legis.state.wv.us /Joint/PERD/perd.cfm | fax: 1- 304-347-4939