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MEMORANDUM

September 15, 2015

TO: Interested Persons
FROM: Matt Becker, Research Analyst, 303-866-4785
SUBJECT: Oversight and Review of Capital Projects

Summary

This memorandum provides information about the oversight and review of capital projects. It defines capital projects and gives a sequential overview of the capital process, including master and program planning requirements, the initial review of capital requests, the role of the Capital Development Committee (CDC) in the review process, and the oversight of projects after an appropriation or spending authority is awarded.

Capital Projects

The CDC is statutorily charged with the general review and oversight of capital projects.¹ The term "capital" collectively refers to three types of projects, as outlined below. Capital construction projects are program-driven. An agency must justify a capital request based on how the project will allow it to improve or alter its ability to provide a certain program or service. Additionally, capital construction does not generally include information technology projects. Beginning in FY 2015-16, information technology capital projects (costing \$500,000 or more) are reviewed and prioritized by the Joint Technology Committee.

- ✓ Capital Construction — capital construction includes the following:
 - ▶ the acquisition of a capital asset, including real property, fixed equipment, and moveable equipment;
 - ▶ the acquisition of any item of instructional or scientific equipment that costs more than \$50,000, except for cash-funded purchases made by institutions of higher education;

¹Section 2-3-1304, *et. seq.*, C.R.S.

- ▶ the disposition of state-owned property;
 - ▶ the construction, demolition, remodeling, or renovation of state-owned property;
 - ▶ site improvement or development of state-owned property;
 - ▶ the installation of fixed or movable equipment necessary for the operation of new, remodeled, or renovated state-owned property;
 - ▶ the installation of fixed or movable equipment necessary for the conduct of programs in or on state-owned property; and
 - ▶ contracting for the services of architects, engineers, and other consultants to prepare plans, program documents, life-cycle cost studies, energy analyses, and other studies associated with any capital construction project or to supervise capital construction.
- ✓ **Controlled Maintenance** — controlled maintenance budget requests are system-or maintenance-driven and typically address facility component systems at the end of their useful life. As such, controlled maintenance involves site improvements and corrective repairs or replacement of the utilities and equipment necessary for the operation of state-owned property, including improvements for health, life safety, and code requirements. Existing state-owned, General Fund-operated buildings and physical facilities and academic buildings are eligible for controlled maintenance funding. In order for a capital asset to be eligible for controlled maintenance funding, a minimum of 15 years must have elapsed since the date of substantial completion or the last renovation. Examples of controlled maintenance projects include replacing deteriorated mechanical equipment and upgrading fire alarm systems. By contrast, operational maintenance is intended to maintain facilities and their component systems to the end of their expected useful life cycles. In Colorado, agencies submit requests for operational maintenance directly to the Joint Budget Committee (JBC) within their operating budgets.
- ✓ **Capital Renewal** — capital renewal budget requests are also system- or maintenance-driven, and address controlled maintenance issues that exceed \$2 million in costs in a single fiscal year or phase, or have grown in scope and are better addressed building by building, rather than system by system. Capital renewal budget requests are prioritized by the CDC along with capital construction budget requests. An example of a capital renewal project is upgrading or replacing the mechanical, electrical, and fire suppression systems in a classroom building.

Facilities Master Planning

State agencies are required to continuously engage in long-range planning for capital needs. Facilities master plans generally assess the condition of existing state-owned or state-controlled facilities, identify trends driving new construction or renovation, and set priorities for future capital projects. State agencies consider need related to size, configuration, location, and function. State agencies may request funds through the regular capital process in order to engage in master planning.

State department facilities master planning requirements.² The executive director of each department, after consultation with the directors of the subordinate agencies, divisions, or

²Section 24-1-136.5, C.R.S.

offices within the department, is responsible for the review of facilities master plans and the submission of such plans to the Office of the State Architect (OSA) for approval. No capital construction may commence except in accordance with an approved facilities master plan. The executive director of each department has the authority to prescribe uniform policies, procedures, and standards of space utilization, except for office space, which is prescribed by OSA.

Higher education institution master planning requirements.³ The Colorado Commission on Higher Education (CCHE) is statutorily charged with the review and approval of long-range plans for all higher education institutions. Facilities master plans are required to conform with educational master plans and are reassessed at least every ten years. CCHE has the power to prescribe uniform policies, procedures, and standards of space utilization.

Facilities Program Planning

Facilities program plans are required for most capital projects. In contrast to a facilities master plan, a facilities program plan is specific to a particular project. Prior to 2015, the Governor's Office of State Planning and Budgeting (OSPB) generally reviewed program plans for state department projects. Going forward, OSA is responsible for reviewing program plans for state department projects, pursuant to Senate Bill 15-270. The Department of Higher Education (DHE) reviews program plans for most higher education institution projects. State agencies may request capital funds through the regular capital process in order to engage in facilities program planning.

Program plans are not required for the following types of projects:

- ▶ controlled maintenance and capital renewal projects;
- ▶ state department projects costing less than \$2 million, regardless of the source of funds;⁴
- ▶ higher education institution state-funded projects costing less than \$2 million, so long as a waiver is requested and received from DHE;
- ▶ higher education institution cash-funded projects costing less than \$2 million; and
- ▶ higher education institution cash-funded projects costing more than \$2 million, but not subject to the Higher Education Revenue Bond Intercept Program.

Under state law, the governing board of a higher education institution is responsible for ensuring that cash-funded projects not subject to other program planning requirements are planned and constructed in accordance with the institution's mission, are of a size and scope to provide for the defined program needs, and are designed in accordance with all applicable building codes and accessibility standards.⁵

Both OSPB and DHE indicate in their annual budget instructions that it is not acceptable for state agencies to reduce large projects into multiple smaller projects in order to avoid program planning requirements. The annual budget instructions include directions for program planning.

³Section 23-1-106, C.R.S.

⁴OSPB has waived the program planning requirements for state-funded projects costing less than \$2 million, so long as sufficient information is included in the budget request documents.

⁵Section 23-1-106 (9), C.R.S.

Submission and Initial Review of Capital Requests

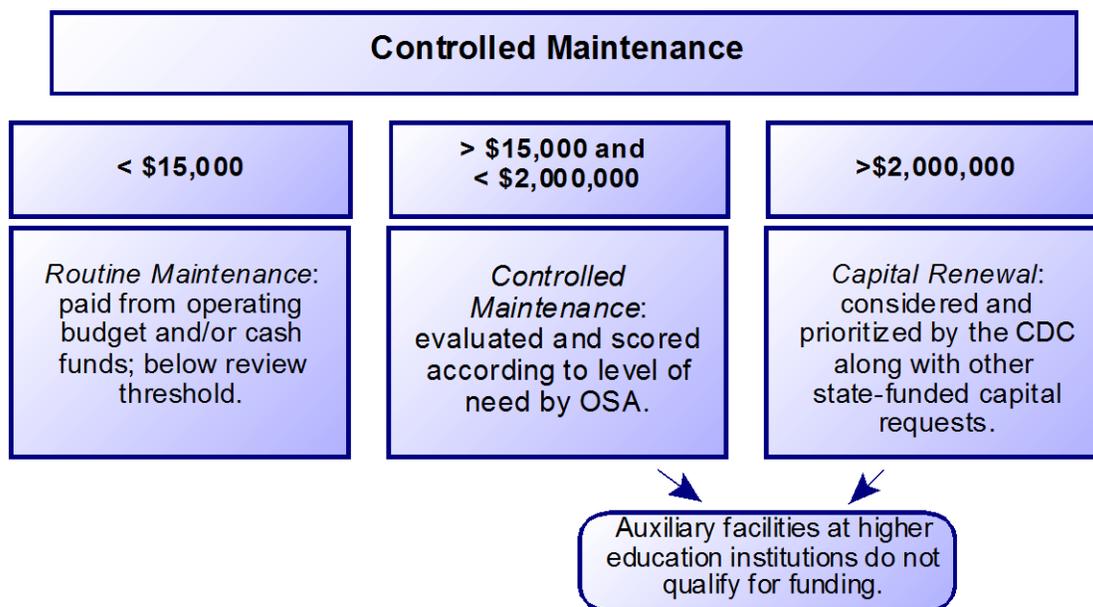
Prior to any legislative review of capital requests, projects are subject to executive branch review. The rules regarding this review vary according to project type, as outlined below.

Controlled maintenance and capital renewal requests. State agencies annually submit controlled maintenance requests to the OSA in the September prior to the fiscal year for which funds are being requested. Beginning in 2016, controlled maintenance budget submissions for the FY 2017-18 budget cycle are due to OSA in July. The OSA is responsible for scoring and submitting a prioritized list of projects to the CDC. Typically, the projects are presented to the CDC as part of the OSA's annual report in December or January. Controlled maintenance projects are scored and ranked based on three factors, including: (1) the severity of the deterioration or compliance issues; (2) what type of building system is being impacted; and to a certain degree, (3) how the submitting agency ranks the project as compared to its other projects.

The OSA is also responsible for the initial review of capital renewal requests. State agencies annually submit capital renewal requests to the OSA in the July prior to the fiscal year for which funds are being requested. The recommendations of the OSA are then forwarded to OSPB. OSPB later forwards and prioritizes these requests to the CDC along with the regular state-funded submissions.

Figure 1 shows the dollar threshold triggering review of controlled maintenance and capital renewal requests.

**Figure 1
Dollar Threshold Triggering Categorization and
Review of Controlled Maintenance Requests**



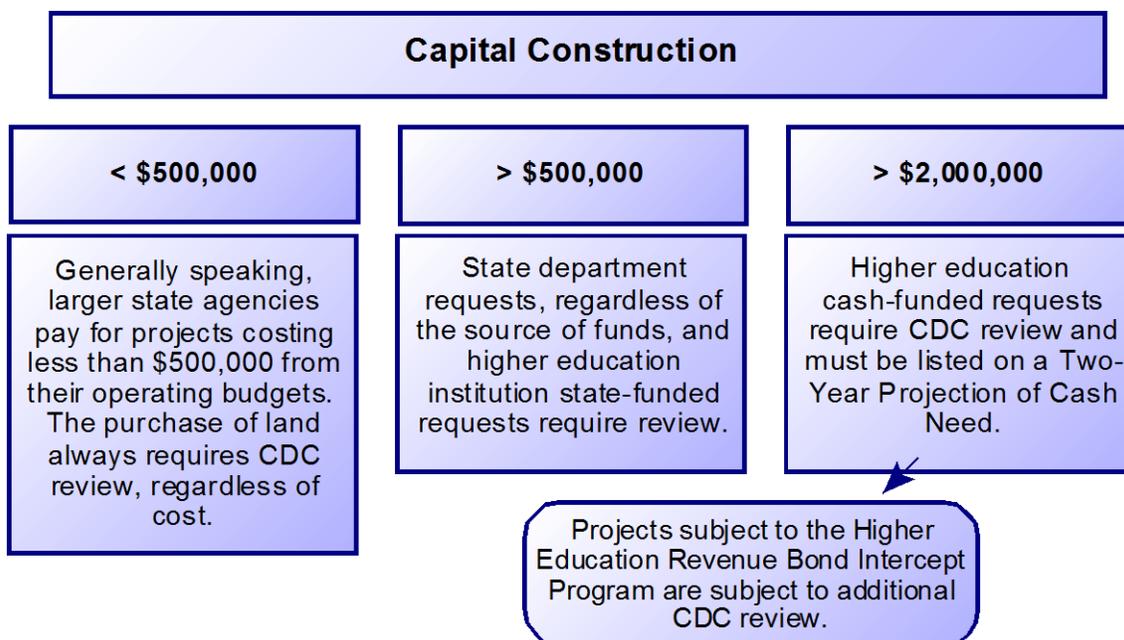
State-funded capital construction requests. State department capital construction requests, regardless of the source or amount of funds, are submitted by state departments to OSPB in the July prior to the fiscal year for which funds are being requested. Cash-funded requests are reviewed and forwarded to the CDC no later than September 15. State-funded requests are reviewed and forwarded to the CDC no later than October 1. The prioritized list of all capital projects, including state-funded higher education projects, is required to be forwarded to the CDC no later than November 1. Beginning in July 2016, for the FY 2017-18 budget cycle and for each fiscal year thereafter, state departments will submit all capital construction budget requests to OSA for review, pursuant to SB 15-270. OSA will then make recommendations to OSPB regarding state department capital construction requests.

Higher education institution state-funded capital construction requests. State-funded capital requests for higher education institutions follow the regular capital budget process. Requests are submitted by institutions of higher education to DHE in the July prior to the fiscal year for which funds are being requested and forwarded to the CDC no later than October 1. The prioritized list of all state-funded higher education capital projects is required to be forwarded to the CDC by CCHE no later than November 1.

Higher education institution cash-funded capital construction requests. Higher education institutions annually submit two-year projections of all capital construction projects to be constructed using cash funds, and costing more than \$2 million, to CCHE. The CCHE in turn annually submits a unified list of the two-year projections received from higher education institutions to the CDC in accordance with OSPB's budget instructions, usually no later than October 1.

Figure 2 shows the dollar threshold triggering review of various types of capital construction requests.

**Figure 2
Dollar Threshold Triggering Review of Capital Construction Requests**



The CDC holds annual hearings, typically in early December, to consider both state- and cash-funded requests from higher education institutions and state departments. No later than February 15, the committee makes a prioritized funding recommendation to the JBC regarding the state-funded requests. In turn, the JBC makes a recommendation for the inclusion of certain capital projects in the annual Long Bill. Most capital construction projects are appropriated in the annual Long Bill.

State department cash-funded requests. The CDC typically submits its recommendations regarding state department cash-funded projects to the JBC early in the legislative session. This recommendation may be submitted concurrent with the state-funded recommendation. Cash funds spending authority for these projects is typically appropriated in the annual Long Bill.

Higher education cash-funded requests. At a minimum, the CDC annually reviews and approves two-year projections of cash need for higher education institutions. If necessary, the CDC may also direct institutions of higher education to modify the projections. These projects are not appropriated. Any project listed and reviewed as part of an institution's two-year projection may commence construction upon approval of an institution's governing board, and without further legislative review, unless it is subject to the Higher Education Revenue Bond Intercept Program (intercept program). If an institution of higher education plans to issue bonds for a project pursuant to the intercept program, CCHE must approve a program plan for the project. The project is subject to additional review and approval by the CDC and the JBC. Project construction may commence upon approval by both the CDC and the JBC.

The intercept program directs the state treasurer to make payments of principal and interest on bonds, on behalf of a state-supported institution of higher education in the event a higher education institution does not make a scheduled payment, unless a higher education institution adopts a resolution stating that it will not accept such payment prior to the issuance of the bonds for a project. Historically, many state-supported institutions of higher education that issue bonds from revenue sources such as student fees do so using the state's credit rating. Therefore, some higher education cash-funded projects are still subject to a separate review and approval by CCHE and the CDC.

For a project to be eligible to participate in the intercept program, the governing body of the respective higher education institution must have a credit rating in one of the three highest categories from at least one nationally recognized statistical credit rating organization. If more than one such organization has rated the institution, the institution cannot have a credit rating that is in a category below the three highest categories. Furthermore, the governing board must have a debt service coverage ratio of at least one and one-half to one, measured by dividing the institution's net revenue available for annual debt service over the total amount of annual debt service and the annual debt service to be issued on behalf of the project.

Higher education institutions are permitted to submit projects subject to the intercept program to the CDC for additional approval at any time during the year. Higher education institutions are also permitted to amend approved two-year projections at any time during the year. The CDC is directed to meet within 30 days of such a submittal during the session, or 45 days during an interim. The receipt of an additional gift, grant, or donation and the increase of up to 15 percent of the project's total cost are not required to be submitted as an amendment, so long as the higher education institution notifies CCHE, OSPB, CDC, and JBC in writing to explain how a project has been amended or enhanced and to verify the receipt of additional moneys.

Project Oversight and Tracking After Appropriation or Spending Authorization is Granted

Once a project receives an appropriation or, in the case of higher education cash-funded projects, receives cash funds spending authority, several executive branch agencies are involved in project oversight and tracking, including OSA, the Office of the State Controller, and DHE. Additionally, the CDC typically tours completed capital construction and controlled maintenance projects located throughout the state each year. The role of each executive agency in project oversight and tracking is discussed below.

Office of the State Architect. The OSA is responsible for capital construction administration. This includes the solicitation and procurement of professional design and construction services, the development of standard contract language, the establishment of project management guidelines, including cost management, the adoption and implementation of building codes and compliance requirements, and the administration of the controlled maintenance program. The OSA maintains an inventory of state-owned, General Fund buildings, and OSA personnel annually visit every site listed on the inventory to meet with facility staff, assess the condition of the facilities, and ensure code compliance. OSA also generates a project status report for every capital construction and controlled maintenance project currently underway. The OSA reports its findings regarding capital construction administration to the CDC annually in December or January.

Office of the State Controller. Personnel within the Office of the State Controller assist state agencies in complying with state fiscal rules and in following generally accepted accounting principles. Capital construction projects appropriated in an annual budget bill must meet three state fiscal rules unique to capital budget requests, or risk the loss of funding. These rules are as follows:

1. The six-month rule states that all major professional services must be encumbered within six months of the time that the bill appropriating the funds becomes law. Higher education cash-funded projects and some programs within the Department of Public Health and Environment and the Department of Public Safety are exempt from this rule;
2. The one-year rule states that spending for a project must commence within one year of the time that the bill appropriating the funds to the project becomes law; and
3. The three-year rule states that all funds for a project must be fully encumbered within three years of the time that the bill appropriating funds to the project becomes law. The three-year clock restarts each time an adjustment to a project is made in an annual budget bill.

The Office of the State Controller also tracks and reports capital construction expenditures for appropriated projects. This report is available upon request.

Department of Higher Education. The DHE annually reports on all spending for higher education projects costing less than \$2 million, regardless of the source of funds. The DHE also annually reports expenditures for higher education cash-funded projects costing more than \$2 million. This report lists each project by higher education institution and gives a brief description, including the type and cost of the project. Both of these reports are available upon request.