CROSSCUTTING ISSUES

RETHINKING THE STATE'S APPROACH TO DEFERRED MAINTENANCE

The current system of funding ongoing maintenance and deferred maintenance creates counterproductive fiscal incentives that encourage the University of California, the California State University, and the California Community Colleges to defer needed maintenance. We recommend specific steps the Legislature should take to resolve the existing backlogs in deferred maintenance and the underfunding of regular maintenance.

BACKGROUND

To keep the state's facilities at the University of California (UC), the California State University (CSU), and the California Community Colleges (CCC) functional for public use, the state and the systems fund both ongoing maintenance and special repair programs.

"Maintenance" includes (1) janitorial and groundskeeping activities and (2) programs to maintain the condition of facilities and infrastructure/utility systems. "Special repair" refers to maintenance projects that are required periodically and are above the level of expenditures needed for routine maintenance. Examples of special repairs include replacing roofs, painting exteriors, and replacing mechanical/electrical equipment.

Deferred Maintenance: Save Now, Pay More Later

When ongoing maintenance is not sustained at an appropriate level and special repair projects are not accomplished as needed, the result is a backlog of projects termed "deferred maintenance." If repairs to key building and infrastructure components are constantly deferred, facilities can eventually require more expensive investments, such as emergency repairs (when systems break down), capital improvements (such as major rehabilitation), or replacement. Generally, deferral of maintenance projects reduces the useful life of facilities and thus increases future capital outlay needs.

Reported Deferred Maintenance Backlogs Are Huge

Over the past 10 to 15 years, California's three public higher education systems have been in a state of constant maintenance deferral. As a result, the UC estimates that its deferred maintenance backlog exceeds $480 million, of which about $251 million are priority-one projects. (Priority-one deferred maintenance projects are those requiring immediate action to return a facility to normal operation, stop accelerated deterioration, or correct a cited safety hazard.) The CSU estimates that its deferred maintenance backlog exceeds $325 million, of which about $108 million are priority-one projects. The CCC Chancellor's Office estimates that the statewide community college deferred maintenance backlog is about $90 million.

These figures represent each segment's evaluation of "need." Based on our campus visits, we believe that the total deferred maintenance backlog is in the range of several hundred millions of dollars; however, our review indicates that the specific magnitude of the problem is uncertain for three reasons:

- The project lists—particularly for the CSU—are not up-to-date.
- Some of the specific projects we have reviewed—such as providing technology enhancements for classrooms—are renovations, not deferred maintenance.
- The estimated project costs have not been independently reviewed—actual costs could be considerably more or less than stated.

Budget History and 1996-97 Proposals

UC and CSU. In 1994-95 and 1995-96, the annual Budget Act and related legislation authorized loan financing for "priority-one" deferred maintenance projects at the UC and CSU that would have an antici-

pated useful life of at least 15 years. The state provided loans of $17 million to $25 million per segment per year. These loans are being repaid through augmentations to the UC and CSU General Fund budgets.

Although the 1996-97 budget proposes a change in funding source for UC and CSU deferred maintenance—no loans this year—it essentially continues the previous years' approach. That is, it augments the segments' operating budgets by an amount that is small in comparison to the total amount of the deferred maintenance backlog. Specifically, the budget allocates about $10 million each to UC and CSU for high-priority deferred maintenance. The UC amount is from one-time general obligation (GO) debt financing and the CSU amount is from General Fund monies (with the intent that this is a "base" adjustment, which would be available annually).

Community Colleges. For the last several years, the state has provided deferred maintenance funding of $8.7 million annually to the community colleges from Proposition 98 funds. Due to a required dollar-for-dollar local match, this annual appropriation generates about $17 million in deferred maintenance activities.

The budget proposes a total of $26.2 million for community college deferred maintenance in 1996-97. It proposes to spend $17.5 million in one-time 1995-96 Proposition 98 funds for CCC deferred maintenance, and waive the local match requirement for these funds. The budget also proposes the ongoing amount of $8.7 million from 1996-97 funds, but maintains the local match requirement for these funds.

PROBLEMS WITH THE STATE'S CURRENT APPROACH

Figure 6 (see next page) summarizes the major shortcomings of the state's current approach to deferred maintenance. Most importantly, the state's current approach treats deferred maintenance as an ongoing "program." The existence of deferred maintenance, however, really represents a maintenance program *failure.* A deferred maintenance project is one that should have been addressed in a prior year under a properly functioning regular maintenance program.

One reason for the failure of the segments' regular maintenance programs is simple—regular, ongoing maintenance has been underfunded. Both the state and the segments have contributed to this underfunding. Moreover, separate funding for deferred maintenance may actually create a fiscal incentive to defer projects rather than deal with them in a more timely manner. Below, we discuss these problems in detail.

Figure 6

Problems in the State's Current Approach to Maintenance

The Current Approach:

Deferred maintenance is a state-funded program. State provides relatively small annual augmentations for this purpose to the systems' base operating budgets.

Problems:

- Does not address underlying causes of deferral:
  - State underfunds regular maintenance programs.
  - Segments not held accountable for spending state maintenance funds for that purpose.
- Counterproductive fiscal incentive—makes projects less expensive for systems to address as deferred maintenance than under a regular maintenance program.

State Funding: Maintenance Has Been a Low Priority. Underfunding of maintenance has occurred in part because the state did not budget sufficient funds to maintain both student instruction and maintenance and special repairs. Maintenance has been viewed as a lower priority than the need to maintain the quantity and quality of direct student instruction. It has been seen as more discretionary and, therefore, deferrable. As a result, spending on maintenance has lagged, and facilities have prematurely deteriorated. In the short-run, this policy has mitigated the effect of the recession's low-revenue years on higher education enrollments and the quality of instruction. If pursued in the long-run, however, it would constrain *future* enrollment and quality levels as the state would eventually have to redirect funds otherwise available for these purposes to repair and replace prematurely worn out buildings and infrastructure.

Segments Not Held Accountable. Underfunding of regular maintenance has also occurred in part because the segments redirected funds budgeted by the state for routine maintenance to other activities. This is because there is no framework under which the state holds the systems accountable for the outcomes of their maintenance programs.

The state has the primary responsibility for funding maintenance at the systems. It has little control, however, for determining ongoing maintenance spending at each campus. Although the state has periodically reviewed some specific maintenance and repair-related issues (such as whether the UC and CSU maintenance cost standards are

consistent), there are serious gaps in oversight. For example, the UC and CSU maintenance standards have not been reviewed since the mid-1980s, and there is no systematic process for reviewing where actual spending levels stand comparison to the standards. As a result, the UC and CSU have significant flexibility in determining the level of maintenance that actually occurs at each campus. Similarly, state funds are allocated to the CCCs on the basis of maintenance and operation workload, but the colleges have virtually unlimited discretion in determining what kinds of maintenance these funds support—or whether they are used to support maintenance at all.

Fiscal Incentive to Defer Makes a Bad Situation Worse. The state's current method of funding deferred maintenance actually provides an incentive for the systems to defer projects. This is because the state has addressed the maintenance problem primarily by adding state monies for deferred maintenance over and above the regular operating budget of the systems. As a result, the current funding arrangement rewards the systems for maintenance deferrals by providing a higher level of funding for deferred maintenance.

For the CCCs, the state provides matching funds under the deferred maintenance program. From the colleges' perspective, therefore, it costs less—in terms of system discretionary funds that must be used—to address a repair under the state-funded deferred maintenance program than it does to address it under a regular maintenance program. Thus, the fiscal incentive offered by the state's approach points in the wrong direction.

NEW APPROACH NEEDED IN 1996-97

We recommend that the Legislature: (1) increase funding for ongoing maintenance and hold the systems accountable for better results, (2) prohibit the addition of any new projects to existing deferred maintenance backlogs, and (3) start a process to eliminate the existing backlogs.

We believe that the improvement in the state's economic and budgetary situation makes this a good time for the state to begin resolving the maintenance problems at the UC, CSU, and CCC. We recommend the Legislature follow the principles outlined in Figure 7 (see next page) as it considers this issue. Figure 7 also summarizes our recommendations to the Legislature for putting these principles into action. Below, we discuss these recommendations primarily as they apply to the UC and CSU. We present a detailed proposal for the community colleges later in our analysis of the CCC budget.

Figure 7

Principles and Recommendations for Reform of Higher Education Maintenance Funding

Principles:

- Adequately fund regular, ongoing maintenance.
- Hold the systems accountable for improving regular maintenance efforts.
- Shift fiscal incentives to discourage deferral of projects.

Recommendations:

- Augment the segments' maintenance budgets in 1996-97.
- Require a segmental funding match and increased maintenance efforts.
- Require all funds budgeted for maintenance to be spent for that purpose.
- Prohibit adding new projects to existing deferred maintenance backlogs after January 1, 1996.
- Reject debt financing of UC deferred maintenance in 1996-97.
- Develop a plan to eliminate existing deferred maintenance backlogs over time.

Provide Adequate Maintenance Funding

The first step in correcting the deferred maintenance problem is ensuring the segments adequately fund ongoing maintenance. The segments report that their maintenance budgets are currently underfunded relative to state standards. Specifically, the UC and CSU advise that their building and infrastructure maintenance budgets (which exclude custodial and grounds maintenance) are at least $33 million and $22 million below the standard, respectively.

Given that this shortfall is the responsibility of both the state and the segments, we recommend that the state and the segments share the burden of restoring maintenance funding to adequate levels. Specifically, we recommend:

- The state provide an augmentation for maintenance to the segments.
- The segments match the augmentation from existing resources.
- The state hold the segments accountable for increased maintenance effort.

State Augmentation. We recommend the Legislature provide a General Fund augmentation of $10 million each to the UC and CSU and $25 million for the CCC. We believe the increase in state funding would be a step towards ensuring that the segments provide an adequate level of maintenance, thereby avoiding higher deferred maintenance costs later.

Segment Match. We recommend the Legislature require the segments to match from internal sources the augmentation provided by the state. Thus, the total increase in maintenance funding for each segment would be $20 million for UC and CSU, and $50 million for the CCC, an amount that would move the segments toward sufficient maintenance funding. In order to match state maintenance funds, we recommend the Legislature redirect funding from other priorities, as shown below:

- For the UC, redirect roughly $5 million in federal overhead funds that we recommend not be used for capital outlay purposes (please see the Capital Outlay chapter of this *Analysis*), and redirect a portion of the budget's proposed $124 million General Fund increase.
- For the CSU, redirect the $9.6 million in planned 1996-97 expenditures for deferred maintenance, and a portion of the budget's proposed $96 million General Fund increase.
- For the CCC, redirect $25 million in general-purpose funding from other priorities.

In planning for future budgets, the state and the segments should take further steps to bring ongoing maintenance funding fully up to the standard.

Accountability. The Legislature should require the segments to use all state funding budgeted for maintenance—plus the proposed segment match—solely for the purpose of maintenance. The Legislature should define "maintenance" in this regard as efforts to maintain facilities and infrastructure, as opposed to janitorial services and groundskeeping. While the latter are important, they have no major effect on the length of facilities' useful life. During budget hearings, we will recommend Budget Bill language necessary to accomplish these recommendations.

Cap the Backlog at Its Current Level

The second step in correcting the deferred maintenance problem is to hold the segments responsible for any new deferred maintenance costs in the future. Given increased funding for regular maintenance, the systems should commit to the proper maintenance of all existing

facilities. The Legislature should make it clear that it will not fund projects that are deferred in the future.

This means the state needs to refine the segments' lists of existing deferred maintenance projects to which no new projects could be added. After the Legislature closes the segments' existing lists, it should ensure that state control agencies have an opportunity to review the projects on the list and determine whether they are appropriately classified as deferred maintenance (as opposed to capital renovation, for example).

We therefore recommend the following supplemental report language, which would require the segments to submit their lists of deferred maintenance projects as of January 1, 1996, to the Legislative Analyst's Office (LAO) and the Department of Finance (DOF). The lists would be reviewed and evaluated by the LAO, the DOF, and representatives of the segments:

> The University of California Office of the President, the Chancellor of the California State University System, and the California Community Colleges Chancellor's Office shall submit to the Legislative Analyst's Office (LAO) and the Department of Finance (DOF) upon enactment of the 1996 Budget Act, the list of segment-wide deferred maintenance projects identified as of January 1, 1996. The LAO, DOF, and representatives of the UC, CSU, and CCCs shall review the projects for merit—based on criteria agreed to by the parties. Based on this process, the LAO and the DOF shall jointly present—no later than November 1, 1996—a final list of all existing deferred maintenance projects at California public postsecondary education institutions.
>
> It is the intent of the Legislature to provide deferred maintenance funding in the future only for those projects included on the list presented on November 1, 1996. It is further the intent of the Legislature that the segments shall not defer maintenance in the future. Given the increased level of funding for regular maintenance provided in the Budget Act, and the Legislature's intent to fully fund regular maintenance in future years, the Legislature regards any deferred maintenance project that is not included on the November 1, 1996 list as the fiscal responsibility of the segment, not of the state.

Reject 1996-97 Debt Financing of UC Deferred Maintenance Projects

We recommend the Legislature reject the proposal to provide $10 million from proposed general obligation bond funds for UC deferred maintenance in 1996-97 (delete Item 6440-001-0658). We believe that the use of debt financing for deferred maintenance projects prior to the thorough review of UC's existing deferred maintenance list (as

described above) would be premature. Moreover, this one-time, relatively small, amount of deferred maintenance funding in the budget year leaves future funding for UC's deferred maintenance backlog an open question. Below we discuss some funding sources—including debt financing—that could be used as part of a long-range plan to reduce the backlog of deferred projects identified in the proposed November 1, 1996 report to the Legislature. In 1996-97, the UC should use funds from its regular operating budget to address any urgently needed deferred maintenance.

Develop a Plan to Eliminate the Existing Deferred Maintenance Backlog

The third step in resolving the deferred maintenance problem is to develop a way to fund the existing deferred maintenance backlog. The Legislature, working with the administration and the systems, should specify a time period—of probably five to ten years—to eliminate the current backlog of projects. The amounts addressed each year should be included in the annual Budget Act—beginning with 1997-98—under a separate deferred maintenance item for each segment.

Potential Funding Sources. To ultimately eliminate the current deferred maintenance backlog, the following sources should be considered:

- State General Fund. For example, the Legislature could set aside for this purpose a portion of tidelands oil revenues, or revenues from the sale of state surplus property.
- Segmental funds.
- Bond funds. We recommended against this source when bonds are proposed as an *ongoing* funding source for deferred maintenance as an ongoing program. However, they are a more appropriate funding source to address a well-defined *one-time* problem.
- Federal overhead funds for the UC.

We think it is appropriate to select a combination of the above (all of which would be temporary in nature) in order to provide as much funding as possible to quickly eliminate the deferred maintenance backlog. Given that the state and the segments each bear some responsibility for the deferral of these projects, we recommend that the Legislature require the segments to match any state funds allocated to reduce the backlog.

CONCLUSION

A long-run strategy to address maintenance failures at the state's higher education segments is essential to protect the state's investment in higher education buildings and infrastructure. Unless the state acts now to (1) bring the systems' maintenance spending to adequate levels and (2) hold the systems' accountable for addressing their ongoing regular maintenance needs, maintenance will continue to be deferred. As a result, the state will face higher future costs of renovating and replacing prematurely worn out facilities.

We recognize that other state agencies and the K-12 schools also have significant deferred maintenance backlogs. We believe, however, that the state should start by addressing the higher education problem because the size of the deferred maintenance backlog in higher education significantly exceeds the combined total of deferred maintenance needs in other state agencies.