The 2014-15 Budget:

Maintaining Education Facilities in California

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LAO

EXECUTIVE SUMMARY

Overview

California Has Vast Inventory of Education Facilities. The state's public education system consists of a substantial amount of infrastructure. California currently has about 10,000 public elementary and secondary schools sites, as well as three State Special Schools (SSS) for blind and deaf children. Together, these public schools serve more than 6 million students statewide, with a total operating budget in excess of $50 billion. The state also has an extensive system of public higher education, with 145 main campuses comprised of more than 13,000 buildings situated on 75,000 acres. Together, the California Community Colleges (CCC), California State University (CSU), and University of California (UC) serve almost 3 million students, with a total core operating budget of $18 billion.

Education Segments Have Routine, Scheduled, and Deferred Maintenance. Whereas routine maintenance of education facilities consists of the frequent upkeep of facilities and grounds (such as annual roof inspections and regular servicing of air conditioning systems), scheduled maintenance involves larger projects intended to preserve the useful life of facilities (such as replacing roofs and air conditioning systems). When these types of projects are not done on time, education segments develop a deferred maintenance backlog. Due to a combination of poor budgeting practices and competing funding priorities, all of the state's education segments currently have a backlog of deferred maintenance projects. Whereas routine maintenance typically is funded annually from segments' operating budgets, major maintenance projects historically have been funded from various sources, including certain categorical programs as well as state and local general obligation bond funds.

Governor's Proposals

Governor's Budget Includes a Package of Proposals for Addressing Maintenance of Education Facilities. The Governor's 2014-15 budget contains several proposals for addressing the education segments' deferred maintenance backlogs. Specifically, the Governor proposes $188 million for the Emergency Repair Program (ERP), which funds urgent projects at certain low-performing schools; $1.4 million in additional maintenance funding for the SSS; and $87.5 million for CCC maintenance. (Because community colleges would be required to provide a one-to-one local match, the Governor's proposal would result in total funding of $175 million for CCC maintenance projects.) For CSU, the Governor proposes a different approach whereby state general obligation and lease revenue bond debt-service payments would be shifted into CSU's main appropriation and the university would become responsible for funding all maintenance and debt-service from within that appropriation. The Governor also proposes authorizing CSU to issue university revenue bonds for certain maintenance projects. The CSU proposal is similar to the new capital outlay process approved for UC last year. (Due to this approach, the Governor does not have a specific maintenance proposal for UC in 2014-15.)

Recommendations

Opportune Time to Address Deferred Maintenance but Various Concerns With Specific Proposals. We commend the administration for highlighting deferred maintenance as a problem and beginning to address it. To the extent the state reduces deferred maintenance at the education segments, it will have taken a positive step toward preserving this infrastructure and potentially reducing future costs. We have certain concerns, however, with the Governor's specific proposals. Our most notable concerns are with the CSU proposal, which would greatly diminish the Legislature's role in reviewing maintenance and capital projects as well as make statewide infrastructure planning even more difficult. We provide the Legislature with recommendations in response to each of the Governor's specific education maintenance proposals. For example, we recommend the Legislature reject the Governor's CSU proposal but begin examining whether systemwide revenue bonds would be a reasonable option for financing future CSU projects.

State Lacks Long-Term Strategy for Addressing Maintenance at Education Segments. Looking beyond 2014-15, we believe the state should have a long-term strategy for ensuring existing maintenance backlogs are addressed, infrastructure is properly maintained moving forward and future backlogs do not develop, associated costs are contained, and students have both safe and academically appropriate facilities. Currently, a long-term strategy for meeting these objectives does not exist. A one-size-fits-all response very likely is not appropriate for such a diverse array of education segments, but segment-specific plans likely could be very helpful in addressing these issues.

Recommend Requiring Segments to Develop and Submit Maintenance Plans to the Legislature. Before the state can determine the best long-term strategy for addressing problems with maintaining educational facilities, it must clearly ascertain the nature and extent of those problems. To this end, we recommend the Legislature require SSS, CCC, CSU, and UC to develop plans that detail how much they set aside annually for scheduled maintenance, how they plan to eliminate their existing deferred maintenance backlogs over the next several years, and how they plan to avoid creating new backlogs thereafter. The information the segments provide in these plans would help not only identify the amount of additional spending that may be warranted but also clarify whether new statutory requirements might be needed to protect state facility investments. That is, if a segment is not setting aside a sufficient amount for scheduled maintenance, the state could consider requiring a certain set aside be made each year. We believe the state working with the segments to develop such long-term plans is critical for ensuring educational facilities are properly maintained moving forward.

Monitor Local Decisions and Conditions at Schools. In contrast to the other segments, we believe the state should not impose additional requirements on elementary and secondary schools at this time. The different approach for schools acknowledges the state's recent decision to shift fiscal decision making and accountability for many aspects of schools' operations—including maintenance—to the local level. If evidence were to emerge in the future indicating that many schools were failing to dedicate sufficient funds to maintaining their facilities, the state could consider imposing additional spending requirements at that time.

INTRODUCTION

The state's public education system includes an immense inventory of infrastructure. This report focuses on the maintenance of this existing infrastructure at elementary and secondary schools, the SSS, CCC, CSU, and UC. The report has three sections. First, we provide background on maintenance terms and funding sources. Next, we assess the Governor's 2014-15 maintenance proposals for each education segment and provide associated recommendations. We then discuss problems with the state's overall approach to funding maintenance of educational facilities and recommend a first step the state could take to improve it.

BACKGROUND

Below, we define key maintenance terms and discuss how the education segments typically fund maintenance projects.

Defining Key Maintenance Terms

Routine, Scheduled, and Deferred Maintenance. As used in this report, "maintenance" refers to one of three types of activities.

- ***Routine Maintenance Is Part of Regular, Ongoing Operations.*** Routine maintenance consists of recurring, usual upkeep for the preservation of facilities and grounds. The purpose of routine maintenance is to keep roofs, mechanical equipment, utilities, and other infrastructure in good condition and working order so they achieve their full useful life span. Examples of routine maintenance include annual roof inspections (and, when needed, minor patchwork) and regular servicing of heating, ventilation, and air conditioning (HVAC) systems. Lack of proper routine maintenance can result in more serious conditions and shorten the useful life of facilities and their physical systems.
- ***Scheduled Maintenance Replaces Systems on a Timely Basis.*** Scheduled maintenance projects are those involving on-time replacements to building systems and other infrastructure that have reached the end of their useful life. Examples include replacing an obsolete electrical system or aging and unreliable HVAC unit. Figure 1 displays various types of common scheduled maintenance projects.
- ***Deferred Maintenance Is Created When Projects Are Not Addressed in a Timely Manner.*** Deferred maintenance

Figure 1

Typical Scheduled Maintenance Projects

- ✓ Replace:
  - Roof
  - Heating, ventilation, and air conditioning systems
  - Electrical system
  - Boiler and chiller
  - Fire alarm system
  - Sewer line
- ✓ Repaint building exterior
- ✓ Repave roadways and walkways

occurs when building systems or other infrastructure are at the end of their useful life and need replacement, but such projects have been delayed due to a lack of resources or a desire to address other funding priorities. When replacements and repairs are put off, schools and campuses increase the risk of facility conditions eventually disrupting instructional services and requiring more expensive investments, such as emergency repairs (when systems break down unexpectedly) or capital improvements (such as major renovations). As a result, while deferring maintenance avoids expenses in the short run, such an approach can result in higher costs in the long run.

Terms Are Not Always Clear-Cut. Though this report uses the above terms and definitions, we acknowledge that in practice the characterization of some projects may be ambiguous as well as differ by school or campus. For example, a college or university that replaces or reconstructs a water or sewer system throughout a campus may consider the project to be capital outlay rather than scheduled or deferred maintenance. Similarly, while major facility renovations generally are considered a type of capital outlay, these projects also often address maintenance needs within a given building (such as replacement of obsolete electrical and fire alarm systems). In addition, schools and campuses may differ on their determinations of what is considered deferred maintenance. For example, one institution might label a noisy HVAC system that is beyond its useful life (according to industry standards) as deferred maintenance, while another may not as long as the system remains in working order and replacement reasonably can be postponed another year.

Criteria for Prioritizing Maintenance Projects Also Can Differ. Just as terms and definitions may vary, the education segments historically have taken different approaches towards prioritizing maintenance projects. Based on our review, the CCC system appears to have the most explicit and comprehensive approach for classifying projects by type and prioritizing them, as discussed in the nearby box.

Funding Maintenance Projects

Various Funding Sources for Maintenance Projects. Education segments typically fund routine maintenance using their general operating funds. Scheduled and deferred maintenance are supported by various sources, with the specific types of funds varying by education segment. For example, Figure 2 shows that school districts traditionally have used general purpose monies, categorical funds, and both state and local bonds to pay for scheduled and deferred maintenance.

Figure 2

Traditional Funding Sources for Maintenance Vary Across Education Segments

	General Purpose Monies	Categorical Program	State General Obligation Bonds	Local General Obligation Bonds	State Lease Revenue Bonds[a]	University Bonds
K-12 Schools	X	X	X	X		
State special schools	X		X			
Community colleges	X	X		X		
CSU	X		X		X	
UC	X		X		X	X

[a] To use lease revenue bonds for maintenance projects the state must employ a special financing mechanism known as "asset transfer."

All three of the state's higher education segments traditionally have used general purpose monies and bonds for scheduled and deferred maintenance. As shown in the figure, the specific types of bonds traditionally used have varied somewhat among the higher education segments. (We discuss differences in types and uses of bonds below.)

Major Maintenance Projects Commonly Financed by Bonds. The education segments tend to use bond financing (rather than paying cash) for particularly large scheduled and deferred maintenance projects. For example, segments sometimes use bond financing for roofs given they tend to have a relatively long life span (typically

CCC Approach to Prioritizing Maintenance Projects

Regulations Set Forth General Criteria for Identifying Maintenance Projects. Statute requires the California Community College's (CCC's) Board of Governors (BOG) to establish criteria for ranking maintenance project proposals. Regulations adopted by BOG require the Chancellor's Office to identify projects in the following three areas—those that are necessary to (1) protect the safety of students and campus staff, (2) prevent disruption to instructional programs, or (3) avoid increased repair or replacement costs in the future. Equal weight is to be given to projects in these three areas.

The CCC Chancellor's Office Has Priority Ranking System by Type of Project. . . For those projects in these three areas, the CCC Chancellor's Office has established a priority ranking by type of maintenance project. Project types, from highest to lowest priority, are as follows:

- Roofs.
- Utilities (such as electrical panels, plumbing, and fire alarm systems).
- Mechanical (such as heating, ventilation, and air conditioning systems).
- Exterior (such as painting and replacing doors and windows).
- Other projects (including resurfacing floors and repaving roadways and walkways).

. . . As Well as Type of Facility. The Chancellor's Office further prioritizes among projects based on the type of facility affected. Facility types, from highest to lowest priority, are as follows:

- Classrooms and laboratories.
- Libraries.
- Faculty and administrative offices.
- Cafeterias.
- Theaters and physical education facilities.
- Roadways and walkways.
- Warehousing and maintenance facilities.

about 25 years). Bonds also are used to renovate entire facilities and replace all (or most) of associated physical systems (thereby sometimes addressing considerable deferred maintenance). As discussed in more detail in our office's August 2011 report, *A Ten-Year Perspective: California Infrastructure Spending*, bonds come in several different forms.

- ***State and Local General Obligation Bonds.*** General obligation bonds for education infrastructure may be issued by (1) the state or (2) school or CCC districts. In both cases, general obligation bonds must be approved by voters to take effect. Whereas the debt-service on state general obligation bonds typically is paid directly by the state General Fund through the annual budget act, the debt-service on local bonds typically is covered by local property taxes.

- ***State Lease Revenue Bonds.*** Unlike general obligation bonds, lease revenue bonds do not require voter approval and instead can be authorized directly by the Legislature. These types of bonds are retired using lease payments financed primarily by the state General Fund. The payments traditionally have been made through the annual budget act, with specific payments linked to the affected education segment.

- ***University Bonds.*** The CSU and UC systems can issue their own bonds to finance infrastructure projects. The CSU may use university bonds only for auxiliary facilities (such as dormitories, dining halls, and parking structures) that generate user fees to pay the debt-service. The UC may issue university bonds for academic and research facilities as well as auxiliaries. The UC may pledge general revenues (including state General Fund and tuition revenue) for debt-service payments.

Funding Choices Have Trade-Offs. The state and segments face various trade-offs in deciding whether to fund maintenance projects upfront using cash or over time using bond financing. Due to interest costs, bonds are more expensive than paying for costs upfront (typically using general purpose or categorical monies). For this reason, paying costs upfront often can be the best financing option. A large backlog of maintenance projects, however, might be difficult to pay for all at once. In this case, the disadvantage of paying more for bond financing may be outweighed by the benefits of completing more projects sooner and mitigating the risk of even more expensive infrastructure costs in the future. Bond financing is most appropriate when the projects being financed preserve the life of a facility. In these cases, the projects will have life spans at least as long as the life of the bond (such that projects are paid off before the end of their useful life).

GOVERNOR'S 2014-15 MAINTENANCE PROPOSALS

In this section, we discuss the Governor's 2014-15 proposals for maintenance at K-12 schools, SSS, CCC, CSU, and UC. We begin by providing a summary and assessment of the Governor's overall approach. Then, for each segment, we: (1) provide an overview of existing maintenance practices and identified projects, (2) describe the Governor's proposal for 2014-15, (3) assess the merits of the Governor's proposed approach, and (4) recommend an alternative approach for the Legislature to

consider. (Since the Governor does not have a new proposal for UC, our discussion for that segment focuses only on its existing practices.)

Overview of Governor's Proposals

The Governor's budget includes a package of proposals for addressing maintenance of education facilities. Figure 3 lists the proposals for each education segment and provides our corresponding recommendations. The figure also shows the cost of identified maintenance projects at each segment. Differences in identified maintenance costs are due to various factors, including the overall size of each of the segments, differences in the segments' routine and scheduled maintenance practices, and differences in the segments' funding priorities during the most recent recession.

Opportune Time to Address Education Segments' Deferred Maintenance. In our recent report, *The 2014-15 Budget: A Review of the 2014 California Five-Year Infrastructure Plan*, we commend the administration for highlighting deferred maintenance as a problem and beginning to address it. To the extent the state reduces deferred maintenance at the education segments, it will have taken a positive step toward preserving this infrastructure and potentially reducing future costs. Given that recent improvements in state revenues are reliant on volatile income sources,

Figure 3

Summary of Governor's 2014-15 Maintenance Proposals and LAO Recommendations

Segment	Cost of Identified Projects	Governor's Proposal	LAO Recommendation
K-12 Schools	Unknown (likely several billion dollars)	Provide $188 million Proposition 98 funds for certain low-performing schools.	Fund projects using LCFF funds or provide $188 million but explore best ways to allocate.
SSS	$25 million	Provide $5 million non-Proposition 98 funds for maintenance but cut base by $3.6 million, for a net increase of $1.4 million.[a]	Reject proposed augmentation but sustain existing funding level for maintenance.[b]
CCC	$1 billion[c]	Provide $87.5 million[d] Proposition 98 funds.	Approve Governor's proposal. Consider providing higher amount, if funds available.
CSU	$1.8 billion[e]	Require CSU to fund maintenance within its main budget appropriation. Authorize CSU to issue revenue bonds for certain maintenance projects.	Reject Governor's proposals but explore bond financing options.
UC	Unknown (likely several billion dollars)	No new proposal. Assumes all infrastructure projects, including maintenance, are addressed within main support appropriation.	N/A

[a] Augmentation could be spent across 2014-15 and 2015-16.
[b] Provide $3.6 million in one-time funds to backfill proposed base cut.
[c] This estimate primarily includes deferred maintenance but also some scheduled maintenance projects.
[d] Colleges would be required to dedicate a like amount of local funding for maintenance.
[e] Estimate provided by CSU. Associated data to support this estimate not available. The university has requested funding and authority to finance $250 million in deferred maintenance projects in 2014-15.
LCFF = Local Control Funding Formula and SSS = State Special Schools.

now appears to be a particularly opportune time for the state to make significant one-time investments in maintaining infrastructure (while avoiding increasing ongoing spending commitments that may be difficult to sustain if state revenues dip in future years).

Governor's Proposed Funding Amounts Largely Arbitrary. While we believe dedicating one-time funding for deferred maintenance makes sense, we are concerned that the Governor's package does not apply consistent criteria for how much maintenance funding to provide each education segment. The Governor's proposals do not appear to consider the existing maintenance practices at each segment, the degree to which each segment's deferred maintenance backlog currently is being addressed, or the size of each segment's backlog.

Recommend Legislature Establish General Guidelines for Determining How Much Maintenance Funding to Provide Each Segment. While how much funding to provide each segment likely will differ based on circumstances unique to that segment, we recommend the Legislature develop general guidelines for deciding how much to provide each segment. For example, funding amounts for the segments could be based on criteria such as: the degree to which projects address urgent life and safety needs; the degree to which existing funding practices are addressing ongoing maintenance needs; the size of the existing deferred maintenance backlogs; and the extent to which the projects reduce future state costs, fulfill legal requirements, or leverage nonstate funding sources.

K-12 Schools

Overview

California Has About 10,000 Public School Sites. The state's public elementary and secondary education system consists of school districts, county offices of education, and charter schools. Altogether, 6.2 million students are enrolled at about 10,000 school sites operated by these agencies. Of the three groups of agencies, school districts are by far the largest group, with about 950 school districts serving 5.8 million students and operating the vast majority of school sites (about 9,000). Each school district is overseen by a locally elected governing board. State-level administration is provided by Department of Education (CDE). In 2013-14, public elementary and secondary schools are receiving operational funding totaling about $50 billion (state General Fund and local property tax revenues). Of this amount, more than $40 billion is allocated for general purposes through the Local Control Funding Formula (LCFF)—a recently established K-12 funding formula designed to provide schools with more flexibility over their spending decisions.

LCFF Funds Maintenance at Every School. All schools are to use a portion of their LCFF allocations for maintenance, as maintenance is considered a basic service and is one of eight areas identified as state priorities. Prior to the LCFF, schools funded maintenance through various sources, including a deferred maintenance categorical program. Deferred maintenance categorical funds could be used for many types of maintenance projects, including major repairs, replacement of roofs and flooring, painting, and lead removal. Schools generally were to match state categorical funds dollar for dollar, though some schools received additional state funding to help with the matching requirement. The deferred maintenance program was eliminated in 2013-14 as part of the LCFF restructuring. In addition, school districts that receive funding from state facility bonds are required to set aside at least 3 percent of expenditures for facility maintenance each year for 20 years—a requirement that still affects many districts.

ERP Funds Maintenance at Small Set of Schools. The state also currently has a categorical program called the ERP that provides funding for urgent maintenance projects at certain school sites. This program was created in 2004 as part of a legal settlement with several advocacy groups that asserted the state was responsible for addressing poor facility conditions at low-performing schools. The program was designed to provide grants to these schools to address urgent projects, such as fixing gas leaks or broken plumbing. The enacting legislation specified the state was to contribute a total of $800 million for the program over several years. The state provided a total of $388 million over the first several years of the program but has not provided any additional funding since 2008-09.

Maintenance at Existing School Sites Likely Costs Several Billions Annually. The state has neither a comprehensive inventory of schools' scheduled and deferred maintenance projects nor an estimate of total associated costs statewide. A recent school infrastructure study estimated the annual cost of all scheduled school maintenance at between $3.5 billion and $7.1 billion. No studies have been undertaken recently to estimate the magnitude of schools' deferred maintenance. Estimating deferred maintenance costs is substantially more difficult because these costs depend on the decisions of individual schools regarding whether to complete particular scheduled maintenance projects on time.

Governor's Proposal

Provides $188 Million for ERP. The Governor proposes to provide $188 million (one-time, Proposition 98 General Fund) for ERP. The funds would be made available only for districts that submitted ERP applications to the state in 2008 and had those applications approved. Funds would be disbursed to districts in the order in which the applications were originally submitted and approved. Just over 100 districts have approved applications on file for emergency repair projects at over 700 school sites. Common projects include replacing or repairing heating and air conditioning units, plumbing, electrical systems, and roofs.

Assessment and Recommendation

Three Notable Concerns With Governor's ERP Proposal. Because ERP projects are focused on emergencies, most projects likely already have been addressed by school districts since they originally applied for funding back in 2008. For example, a district almost certainly would have had to address gas leaks, broken heating and air conditioning units, and leaking roofs. Because most (if not all) originally approved projects likely have been completed, the ERP funds allocated under the Governor's proposal effectively would provide some districts with additional general purpose monies. The Governor's proposal also may provide funds to districts that no longer are among the lowest-performing schools—that is, they may no longer meet the program's basic eligibility criteria. Finally, providing special funding for maintenance through a categorical program such as ERP runs counter to the state's more recent decision to eliminate categorical programs, including the deferred maintenance program, and require schools to address their facility maintenance with LCFF funds. (The LCFF also provides substantially higher funding levels to schools with high concentrations of low-income students—some of the same schools intended to benefit from ERP.)

Recommend One of Three Options for Addressing ERP Obligation. The first option is to approve the Governor's proposal, which would provide funds to districts that applied several years ago for emergency repairs. This option would honor the state's commitment from many years ago to pay these districts, but it may not

have much impact on improving school facilities today since the funding likely would function as general purpose monies for most of these districts. The second option is to open up a new round of ERP applications for either low-performing schools or all schools. This option has the advantage of targeting funding to projects that exist today but would change the distribution of funding across school districts. A third option for the Legislature is to adopt statutory language indicating the state has met its obligation for ERP since it provided billions of dollars in new LCFF funding in 2013-14 and requires that districts use a portion of this money to maintain their facilities. This option would streamline the state's school finance structure but also would change the distribution of funding across districts.

SSS

Overview

State Operates Three Special Schools and Three Diagnostic Centers. The SSS consist of three specialized schools for deaf and blind students: the California Schools for the Deaf in Fremont and Riverside (which each serve around 400 students) and the California School for the Blind in Fremont (which serves around 70 students). About half of the students attending these schools reside in on-site dormitories while about half attend as "day students." Additionally, the state operates three diagnostic centers (located in Fremont, Fresno, and Los Angeles) that identify students' disabilities and offer training to families and local educational agencies. (Throughout this report, our discussion of SSS includes all six locations—the three schools and three centers.) The schools are administered by CDE and have a support budget of about $95 million annually. The annual budget appropriation for the SSS has remained relatively constant in recent years—even throughout the economic downturn—and historically has not been linked directly to the number of students actually served by the schools and centers.

Maintenance Projects Typically Funded From SSS Operating Budget. The state budget does not provide funding explicitly for maintenance at the SSS. Rather CDE is responsible for determining how much to set aside for maintenance projects from the operating funding provided for the SSS. According to CDE, prior to 2002 the department dedicated about $500,000 annually for maintenance. This was insufficient to address scheduled maintenance and a corresponding backlog of deferred maintenance projects developed. Beginning in 2002, CDE began setting aside $2.4 million (or slightly more than 2 percent of the SSS operating budget) for annual maintenance projects. The department indicates this amount is sufficient to address scheduled maintenance projects and begin to "chip away" at the backlog of deferred projects. (In 2012-13, CDE redirected an additional $2.3 million in unspent prior-year funds to address a larger number of deferred projects, spending a total of $4.7 million.) The existing list of deferred maintenance projects for the six SSS facilities totals $25 million.

Legislature Reduced Ongoing SSS Budget, Backfilled With One-Time Funds in Two Most Recent Years. Beginning in 2012-13, the state reduced annual ongoing state General Fund support for the SSS by $1.8 million. In both 2012-13 and 2013-14, however, the Legislature provided a like amount of one-time federal special education funds to backfill this reduction. As such, the SSS has been able to sustain overall spending levels—including maintenance expenditures—despite the reduction in state support.

Governor's Proposal

Governor Proposes Additional One-Time Funds for SSS Maintenance. The Governor proposes providing $5 million (one-time, non-Proposition 98 General Fund) to SSS. Of this amount, $3.6 million would continue backfilling the $1.8 million reduction to the SSS operating budget (described earlier) for 2014-15 and 2015-16. (The administration has not indicated whether the SSS operating budget would be reduced permanently beginning in 2016-17.) The remaining $1.4 million represents additional maintenance funding for SSS to spend across 2014-15 and 2015-16. Though the administration has not provided detail on which specific maintenance projects would be supported with the additional funds, CDE has indicated it would undertake some major projects (including replacing roofing and improving theater accessibility) and some minor projects (including painting classrooms and replacing carpets).

Assessment and Recommendation

Governor's SSS Proposal Provides Too Much Funding. We believe the Governor's proposal for funding maintenance projects at the SSS is excessive for two reasons.

- ***Solid Maintenance Plan Already Being Implemented.*** The CDE already is implementing a long-term plan to budget $2.4 million annually to address both scheduled and deferred maintenance. We believe this plan is adequate both to avoid worsening conditions and to make progress on addressing the deferred maintenance backlog.

- ***Not All Projects Represent Urgent Needs.*** In reviewing how CDE plans to use any additional maintenance funding, we believe not all of CDE's identified projects represent pressing health and safety needs. For example, we do not believe that buildings would be unsafe or at risk of further damage if funding were not immediately dedicated to painting interior classrooms and replacing carpets.

In-Depth Review of State's Approach to Funding SSS Needed Prior to Additional Investments. We believe making additional investments in the SSS would be premature before the state addresses several longstanding concerns we have identified with the overall SSS funding structure. Issues we believe merit more in-depth exploration include the disconnect between funding levels and student enrollment, as well as inconsistencies in the state's approach to funding comparable special education services provided by the SSS and local educational agencies.

Recommend Sustaining Existing Funding Level for Maintenance, Not Providing Additional Funding. Because we do not believe the SSS are among the highest priorities for *additional* state investments, we recommend rejecting the Governor's proposed $1.4 million augmentation. Nonetheless, we think the state should prioritize maintaining existing facilities in safe, working condition. To this end, we recommend the Legislature provide the $3.6 million in one-time state funds to continue backfilling the base reduction in the SSS operating budget, thereby enabling CDE to sustain its existing maintenance practices over this period. This funding level would be sufficient to complete projects addressing urgent health and safety needs. While this approach would use one-time funds to backfill an ongoing cut over the next two years, we believe such an approach makes sense given it would provide the Legislature time to conduct an in-depth review of the SSS before making new ongoing state commitments.

CCC

Overview

Community Colleges Consist of 112 Colleges Located Throughout the State. The CCC system is made up of 112 colleges operated by 72 locally governed districts throughout the state. The Board of Governors oversees the statewide system and appoints a chancellor to run day-to-day statewide operations at the Chancellor's Office (located in Sacramento). The system has a total of about 5,300 buildings and 24,000 acres of land. In 2013-14, CCC is providing instruction to about 2.3 million students and receiving about $7 billion in state operational support (which includes state General Fund, local property taxes, and student fee revenues).

Categorical Program Provides Funds for Maintenance. Community colleges typically cover maintenance costs using three primary funding sources: categorical funds, apportionments (general purpose funds), and local general obligation bond monies. The CCC's maintenance categorical program is called "Physical Plant and Instructional Support." The "Physical Plant" component of the program funds scheduled and deferred maintenance. (The "Instructional Support" component of the program funds replacement of instructional equipment and library materials.) To qualify for these maintenance funds, districts must meet three statutory requirements: (1) adopt and submit to the CCC Chancellor's Office a five-year plan of maintenance projects, (2) dedicate at least half of 1 percent of district apportionment funds for routine maintenance; and (3) provide a one-to-one local match (using apportionments, local bond monies, or other non-categorical program funds). Before districts receive categorical monies, they must submit to the CCC Chancellor's Office information on the specific projects they propose to fund from their five-year plans, including the nature of and justification for each project, estimated cost, and implementation time frame. As discussed earlier, districts rank their project proposals in priority order using criteria developed by the CCC Chancellor's Office. Upon approval of these plans, the CCC Chancellor's Office allocates categorical funds to districts on a per-student basis.

Funding for CCC's Maintenance Categorical Program Has Been Sporadic. Over the past decade, the state has been inconsistent in providing dedicated funding for CCC maintenance through the categorical program. Throughout the mid-2000s, annual budgets provided between $11 million and $14 million (Proposition 98 General Fund) for scheduled and deferred maintenance through the categorical program. Due to the state's fiscal crisis, the *2009-10 Budget Act* eliminated all funding for the categorical program. The program did not receive another appropriation until the *2013-14 Budget Act*, which provided $15 million for maintenance.

CCC Has Plan to Undertake About $1 Billion in Maintenance Projects Over Next Five Years. The CCC system has identified a total of about $1 billion in scheduled and deferred maintenance projects that it would like to see addressed over the next five years if funding is available. The CCC Chancellor's Office's database that contains districts' five-year plans does not disaggregate costs by scheduled and deferred maintenance projects. Based on our discussion with several districts, however, we estimate that roughly 90 percent of overall costs identified in the plans (approximately $900 million) are deferred maintenance projects.

Governor's Proposal

Governor Proposes Additional Support for CCC Maintenance. The Governor's budget provides $87.5 million (one-time, Proposition 98

General Fund) for CCC's maintenance categorical program. Because districts would be required to provide a one-to-one local match, the Governor's proposal would result in total funding of $175 million for CCC maintenance projects. Districts would use these maintenance monies to fund various types of projects, beginning with the highest priority projects—roof repairs and replacements in classrooms and laboratories. (The Governor's proposal would provide an additional $87.5 million for the Instructional Support component of this categorical program.)

Assessment and Recommendations

CCC Maintenance Has Been Underfunded. As noted earlier, CCC has identified $1 billion in near-term maintenance projects. This is considerably higher than the about $600 million in costs identified by the system in the late 1990s and early 2000s. The major reason for the growth of these costs is that maintenance in recent years has been underfunded. Despite its importance in supporting CCC's educational mission, maintenance generally has been viewed both by the state and districts as a lower priority than other CCC programs.

Recommend Approval of Governor's Maintenance Proposal, Consider Additional Increases. Given the relative lack of state funding for CCC maintenance in recent years, we commend the Governor for making CCC maintenance one of his budget priorities, and we recommend the Legislature approve the proposed $87.5 million for the CCC maintenance program. Even with the required local match, however, we note that the amount dedicated to maintenance in 2014-15 would be well short of the $1 billion in total identified costs. If additional funding were available, we recommend the Legislature consider increasing the amount of one-time funding for CCC maintenance. (Updated May revenue estimates could result in a higher Proposition 98 minimum funding guarantee for 2013-14, 2014-15, or both years.)

Rethink State's Long-Term Approach to Funding CCC Maintenance. If the Legislature were to provide roughly $100 million per year for the subsequent four years and community colleges continued to match this funding, then CCC's existing $1 billion deferred maintenance backlog would be eliminated by the end of 2018-19. As we discuss in more detail in the last section of this report, we recommend the Legislature consider ways to ensure a new deferred maintenance backlog does not arise thereafter. To avoid a new backlog, CCC requires better ongoing maintenance practices. Community colleges generally do not appear to have a regular practice of investing adequate amounts in scheduled maintenance such that projects are done on time and not deferred. Moving forward, we recommend the Legislature revisit the current state policy of having a special pot of funding for deferred maintenance (which ideally would not exist) in favor of a new expectation that districts accommodate annual maintenance needs within their general operating budgets. Such an approach would send a stronger message to community colleges that proper ongoing maintenance is a core local responsibility.

Insufficient Justification for Instructional Support Proposal, Recommend Legislature Request Additional Information. While we believe the Governor's maintenance proposal has merit, the administration has not justified its companion request for $87.5 million to replace CCC instructional equipment and library materials. According to the administration, the proposed amount was determined merely by following the historic practice of splitting categorical program funds evenly between maintenance and instructional support. Unlike with maintenance, the CCC Chancellor's Office does not maintain a systemwide list of instructional support

priorities and corresponding costs. In fact, the administration has not been able to provide any information (such as annual systemwide equipment expenditures) that would suggest whether $87.5 million is an appropriate level of funding. This lack of data makes assessing the merit of the Governor's proposal difficult. We recommend the Legislature direct the administration to provide justification for the requested $87.5 million. If the administration is not able to provide such justification, we recommend the Legislature redirect all or a portion of these monies to deferred maintenance or other Proposition 98 priorities.

CSU

Overview

CSU Includes 23 Campuses and 8 Centers. The CSU serves a total of 445,000 undergraduate and graduate students at its 23 campuses and 8 off-campus centers located across the state. The system is overseen by a 25-member Board of Trustees, with most of the members appointed by the Governor. The Trustees appoint a chancellor that oversees campus presidents and serves as the head of the CSU Chancellor's Office (located in Long Beach). The CSU system has a total of 2,180 buildings on 21,364 acres of land. The system's facilities currently are valued at about $14 billion. In 2013-14, CSU is receiving $5.5 billion in core funding ($2.8 billion General Fund support and $2.7 billion student fee revenue).

Campuses Fund Some Maintenance Through Operating Budget. The uses of core operating funds are determined by the CSU Trustees, CSU Chancellor's Office, and individual campus presidents. Between 2007-08 and 2012-13, many campuses reduced maintenance spending in response to reductions in state funding, particularly to help mitigate reductions to academic programs and student services. Systemwide, campuses spent about $135 million in core operating funds on maintenance in 2012-13 (about 3 percent of CSU's core operating budget).

Larger Maintenance Projects Approved Through Capital Outlay Process, Funded Using Bonds. The CSU annually submits a five-year capital outlay plan to the Department of Finance (DOF). The CSU Chancellor's Office prioritizes those campus projects that address structural and health or safety code deficiencies as well as those projects that make facilities operable by providing equipment or replacing physical systems. Both of these priority areas may include maintenance projects (such as utility system replacement) as well as projects not considered maintenance (such as new construction or program-related renovation). The Governor typically includes some projects from the CSU five-year plan in his proposed budget, financing them with state general obligation or lease revenue bonds. The state has approved no higher education general obligation bonds since 2006, however, and state lease revenue financing has been minimal in recent years. As a result, CSU has continued to defer a number of large, high-priority maintenance projects.

CSU Estimates $1.8 Billion in Deferred Maintenance. Based on campus surveys, CSU estimates the value of this backlog at $1.8 billion. (Both the Governor's budget and Trustees' budget request mention a different total backlog—$473 million. This lower amount, identified as CSU's "priority" deferred maintenance backlog, is not associated with specific projects. Instead, it is a decades-old amount of deferred maintenance adjusted for inflation.) The CSU's estimate of total deferred maintenance reflects a high-level assessment because the Chancellor's Office does not maintain a detailed, project-level maintenance list. (That is, CSU does not have a list of all maintenance projects that is comparable to its five-year capital outlay plan.)

Governor's Proposal

Governor Proposes New Capital Outlay Process for CSU. Similar to a new capital outlay process approved for UC last year, the Governor proposes to shift general obligation and lease revenue bond debt-service payments into CSU's main appropriation. Moving forward, the state no longer would adjust CSU's budget for changes in debt-service costs. Instead, the state would provide annual, unallocated base increases and the university would be responsible for funding all maintenance and debt-service from within its main appropriation. (The proposed unallocated base increase for 2014-15 is $142 million.) Under the Governor's proposal, CSU would issue its own university bonds for various types of capital and maintenance projects and could restructure its existing lease revenue bond debt. Compared to state lease revenue bonds, university bonds likely would allow CSU to finance large maintenance projects more easily. (To use state lease revenue bonds for maintenance, the university typically has to undertake a special process known as "asset transfer" to identify sufficient collateral.) To use its new authority, CSU would be required to submit project proposals to DOF for approval, with a 60-day notification period provided to the Joint Legislative Budget Committee. (For energy efficiency and maintenance projects, the notification period would be 30 days.) The CSU's capital and maintenance projects no longer would be reviewed as part of the regular budget process.

Using Governor's Approach, CSU Proposes to Reduce Deferred Maintenance Backlog—but Only If Fully Funded. According to the CSU Trustees' November 2013 budget request, the university would use the proposed new authority and a portion of its General Fund augmentation to issue $250 million in university bonds each year for the next three years primarily to address priority deferred maintenance projects. Debt-service payments for these bonds, approximately $15 million annually for each $250 million in debt issued, would come from CSU's support appropriation. Annual augmentations under the Governor's long-term funding plan for the university would provide about $10 million in new funding each year from rolling CSU's debt-service into its support budget, and CSU would provide the remaining $5 million from the university's general purpose funding. More recently, however, the CSU Chancellor's Office has indicated that the university is reluctant to commit operating funds to begin addressing the deferred maintenance backlog unless it receives full funding of the Trustees' budget request and additional funding to recognize upcoming spikes in debt-service payments for already-approved projects. (The Governor's proposed budget provides about 60 percent of the Trustees' requested amount and does not address future increases in debt-service payments.)

Assessment and Recommendations

Several Serious Concerns With Governor's Proposal. The Governor's approach for CSU has several serious drawbacks. Most troubling, the Governor's approach diminishes the Legislature's role in capital and maintenance decisions for the university. That is, the Governor takes the Legislature out of the business of reviewing CSU projects through the regular budget process. The DOF would approve the university's projects through an abbreviated review process, further reducing transparency and precluding public input. In addition, the Governor's proposal would make planning for infrastructure spending statewide more difficult, as the state would not be able to prioritize funding as easily among higher education and other program areas. Another concern with the Governor's proposal relates to the amount of funding initially rolled into CSU's main support appropriation. Specifically, the proposal presumes

the amount of debt-service related to one particular fiscal year is an appropriate amount upon which to base ongoing infrastructure needs, yet it offers no evidence to this effect. In fact, general obligation bond debt-service for existing projects can fluctuate notably over time due to bond authorizations and sales. Furthermore, past bond authorizations may not accurately reflect future facility demands.

Proposal Does Not Specifically Address Maintenance Funding. Because the Governor's proposed General Fund augmentation for CSU is unallocated, it does not specifically address maintenance needs. A recent CSU internal audit estimated that an additional $99 million in annual maintenance spending would be necessary to prevent growth in the current deferred maintenance backlog. Given their stated priorities, the Trustees would be unlikely to allocate this amount for maintenance from the university's proposed $142 million General Fund augmentation. In addition, the CSU Chancellor's Office has indicated that it would not address maintenance needs for several years if provided the funding level proposed in the Governor's budget. As a result, the deferred maintenance backlog would continue to grow.

Proposal Raises Questions About Appropriate Funding Sources for Deferred Maintenance Projects. The university's plans for financing deferred maintenance project with long-term bonds raises larger questions regarding borrowing for these costs. On the one hand, if the projects preserve the useful lives of facilities for at least the term of borrowing, this approach may be justified. Debt-service costs could be lower for university bonds than for state lease revenue bonds because the university program currently has a slightly better credit rating than the state. In addition, university bonds would provide more flexibility than state lease revenue bonds to finance large maintenance projects. On the other hand, borrowing tends to be about one-third more expensive than pay-as-you-go funding.

Recommend Legislature Reject Governor's Proposal. We recommend rejecting the Governor's proposal to (1) move current debt-service amounts into the university's support budget, (2) change the approval process for university projects, and (3) provide statutory authority for CSU to issue university bonds to address deferred maintenance needs. If the Legislature wishes to begin exploring the possibility of using university bonds to finance large maintenance projects at CSU (while maintaining the current process for reviewing projects), it could direct CSU and DOF to provide additional information regarding the relative costs, benefits, and risks of state and university bonds. Depending on what it learned, the Legislature could consider authorizing this financing mechanism for CSU next year.

UC

Overview

UC Operates Ten Campuses Across the State. The UC serves a total of 243,000 undergraduate, graduate, and professional students at ten university campuses, including five medical centers, located across the state. Campus facilities include classrooms, laboratories, libraries, dormitories, dining halls, student unions, and research and office space. In total, UC maintains nearly 5,800 buildings but only about half of its space is eligible for state funding. State funding generally is limited to buildings serving core instruction and research purposes. In 2013-14, UC expects to spend $5.8 billion on its core instruction and research programs, with $2.8 billion coming from the state General Fund and $2.5 billion from student tuition payments. (The remainder comes from a few other revenue sources, such as a portion of federal research grant overhead.) The university

is overseen by a Board of Regents, comprised mainly of members nominated by the Governor. The Regents appoint a president that oversees campus chancellors and serves as the head of the UC Office of the President (located in Oakland).

Maintenance Funded Through Operating Budget and Bond Funds. The state does not designate any operating funds in UC's state budget appropriation specifically for maintenance. Instead, the state allows the university to decide how much to spend on maintenance. (The UC Office of the President, in turn, allows each campus to determine how much to spend on maintenance.) In 2013-14, UC expects to spend about $200 million from its operating budget on routine maintenance, including $176.5 million for building maintenance and $24.4 million for grounds maintenance. The university reports that some campuses spend operating funds on scheduled and deferred maintenance too, but was unable to provide related expenditure information. Regarding bond funds, the state historically issued general obligation and lease revenue bonds that could be used for certain large scheduled and deferred maintenance projects. In 2013-14, the state granted UC the authority to issue university bonds backed by state funds. (As noted in the CSU discussion, the state also shifted funding for state debt-service into UC's operating budget and removed the review of projects from the regular budget process.)

UC Estimates Billions of Dollars in Deferred Maintenance but Cannot Provide Associated Data. The UC indicates it has billions of dollars in deferred maintenance. The university states that it does not have a more specific estimate because it does not have a project-level maintenance list. The university reports that it currently uses a "life-cycle" model to track maintenance that assigns a standard useful life to each building system based on age. For example, the model might assume that a roof lasts 25 years. In reality, however, building systems may need to be replaced earlier or later depending on a variety of factors. To have more accurate data on building conditions, UC is in the process of implementing a new tracking system that would provide real-time condition assessments on all university buildings. The university states that it will have a more accurate estimate of scheduled and deferred maintenance once this new system is ready in 2017.

STATE NEEDS A LONG-TERM STRATEGY

Below, we discuss our concerns with the state's overall approach toward maintaining education facilities and then recommend a first step for how the state might develop a long-term strategy for reducing—and eventually eliminating—the state's significant deferred maintenance backlog. Our main concerns and corresponding recommendations echo issues we raised earlier this year in related reports, including *A Review of the 2014 California Five-Year Infrastructure Plan*.

Concerns With State's Existing Approach

We have three main concerns with the state's overarching approach to maintaining education facilities. Given some education segments have more sophisticated maintenance practices and data compared to others, these concerns more strongly relate to some segments than others.

Existing Budget Practices Contributing to Deferred Maintenance Backlog. The existing backlog of deferred maintenance projects suggests that the education segments have not dedicated sufficient funds to maintaining facilities. These

trends likely result from problematic budgeting practices at both the state and local levels. During the recent economic downturn, the state implemented unallocated funding reductions across the education segments, yet encouraged the segments to preserve existing service levels for students. The segments responded by reducing expenditures for facilities and deferring scheduled maintenance projects. Though most of the segments' backlogs grew during the recession, the segments had deferred maintenance backlogs even prior to that time, suggesting they historically have not adequately prioritized spending on maintenance.

State Lacks Consistent Definitions and Adequate Data to Assess Magnitude of Deferred Maintenance Backlog. Determining the appropriate amount of maintenance funding to provide is difficult when the state cannot identify the magnitude of maintenance projects at each segment. As discussed in the previous section, some education segments (SSS and CCC) have provided the state with a comprehensive list of their existing deferred maintenance projects, whereas others (school districts, CSU, and UC) have not. Moreover, each segment uses somewhat different definitions for classifying maintenance projects as well as different criteria for prioritizing amongst projects, making cross-segmental comparisons challenging.

No Long-Term Plan for Eliminating Existing Deferred Maintenance Backlog. Even if the state could identify the existing backlog of all segments' deferred maintenance, neither the segments nor the state has developed a comprehensive plan for how and when to address these projects. As a result, the state does not know if backlogs over the next few years will grow, shrink, or be eliminated. It also does not know how most of the segments would finance any reductions in their backlogs over time. It also does not know how most of the segments will prioritize among overdue and otherwise scheduled maintenance projects.

Recommendations for Improving Overall System

Require Segments to Develop and Submit Maintenance Plans to the Legislature. Before the state can determine the best strategy for addressing existing problems with maintaining educational facilities, it must clearly ascertain the nature and extent of those problems. To this end, we recommend the Legislature require SSS, CCC, CSU, and UC to submit maintenance plans to the legislative fiscal committees by January 1, 2015. (As discussed below, we recommend a somewhat different approach for school districts.) Producing these plans likely will be easier for the two segments (SSS and CCC) that already maintain relatively detailed information on their maintenance projects, whereas compiling the requested data may be a more involved process for CSU and UC. We recommend the plans be required to contain information on both scheduled and deferred maintenance, including:

- A description of the definitions used to classify maintenance projects and the criteria used to prioritize among types of projects.
- A description of the approach used over the last ten years to fund maintenance projects, as well as the separate amounts and funding sources annually allocated for scheduled and deferred maintenance.
- A brief description of types of outstanding deferred maintenance projects along with associated costs.
- A multiyear expenditure plan for how to address this backlog of projects, including proposed funding sources.

- A plan for how to avoid developing a maintenance backlog in the future. This plan should identify how much funding the segment annually would need to set aside for maintenance to achieve this objective based on a clearly specified industry standard practice.

Consider Future Budgetary Requirements to Encourage Proper Maintenance Practices. The information the segments provide in these maintenance plans would help not only identify the amount of additional spending that may be warranted but also clarify whether new statutory requirements might be needed to protect state facility investments. That is, if a segment is not regularly setting aside enough to cover scheduled maintenance, the state could consider requiring the segments moving forward to set aside a certain amount annually to maintain facilities. (Such a practice would be comparable to the requirement that traditionally has applied to school districts receiving state facility bond funding.)

Monitor Local Decisions and Conditions at Schools. In contrast to the other segments, we believe the state should not impose additional maintenance requirements on elementary and secondary schools at this time. A different approach for schools acknowledges the state's recent decision to shift fiscal decision making and accountability for many aspects of schools' operations—including maintenance—to the local level. Schools are required to spend a portion of their LCFF allocation on maintenance because maintaining facilities in good repair is one state priority area that schools must address in their Local Control and Accountability Plans. Should evidence emerge—via these plans or other means—that many schools are failing to dedicate sufficient funds to maintaining their facilities, the state could consider imposing additional spending requirements in the future.

CONCLUSION

A deferred maintenance project is one that should have been addressed earlier under a properly functioning maintenance program. The existence of deferred maintenance thus represents a maintenance program failure. As such, the state should pursue a strategy that seeks to eliminate deferred maintenance from its education segments. While a one-size-fits-all solution is not appropriate for such a diverse array of education segments, we believe the state should have a long-term strategy for ensuring existing maintenance backlogs are addressed, infrastructure is properly maintained moving forward and future backlogs do not develop, associated costs are contained, and students have both safe and academically appropriate facilities. Currently, a long-term strategy for meeting these objectives does not exist—with no clear strategy evident among the administration, state, or segments. We believe the state working with the segments to develop such long-term plans is critical for ensuring educational facilities are properly maintained moving forward.

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