



Research Brief

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Capital Outlay Reform Agenda for Louisiana

Introduction

It seems the state's capital outlay process will be getting a makeover this year. Several reform bills are moving through the Legislature. Each would make some long-called-for improvements to the process, but none can be called comprehensive reform. The proposed changes fail to address sufficiently the most serious problems with the current process used to determine which construction projects will receive state funding.

There are three major problems with the current capital outlay process:

1. Governors can use capital outlay commitments as a bargaining tool when they are trying to get legislative support for their agendas.
2. Funding is committed for projects years in advance with no limit on how large a backlog is allowed.
3. Some projects are authorized with little objective or rational basis.

One bill is supported by the governor and likely to pass, but it would fail to tackle the most important problem with the state's capital outlay process: capital outlay project funding is controlled by the governor and enables state construction dollars to be spent for their political impact rather than objective merit. By some accounts, that bill may effectively strengthen the governor's power. The other bills would make some effort to rein in the governor's power over project selection. However, none of the bills would implement several other important changes to the process outlined below.

Without shifting responsibility for project selection to the Legislature, the state's capital outlay process will continue to be marred by political gamesmanship. This research brief outlines the essentials of comprehensive capital outlay reform that would achieve a better balance of power between the governor and Legislature and would require more transparent strategic planning for the state's construction dollars.

The push for reform this year was activated by the extraordinary level of over-commitments left by the Blanco administration. The list of projects committed to be funded with future debt issues (Priority 5 non-cash lines of credit) will prevent or severely limit the new governor and new Legislature from pursuing their own ideas on how state capital outlay funding should be spent in the next four years. The Priority 5 non-cash line of credit commitment is essentially a promise (a foot in the doorway) to provide funding for project cash flow not in the current year, but in future years. The state limit on new debt for capital outlay is \$350 million this year (adjusted annually for inflation), and the total projected costs of projects in queue is more than \$1 billion.

The cost of outstanding projects promised funding in last year's capital outlay budget was more than twice what it has been in any single year in at least the previous 12 years, and is probably the highest it has ever been in capital outlay history.

When a state agency or non-state entity project receives a Priority 5 non-cash line of credit, the entity typically expects that all or part of its Priority 5 funding will move up to Priority 1 and receive a cash line of credit in the

subsequent fiscal year to meet the cash flow needs of the project. At a rate of \$350 million per year, it would take about four years to fund the entire outstanding commitment.

The bottom line is that if this issue is not effectively dealt with, there could be no new cash line of credit capacity for the new governor or the new Legislature to use on new projects for the next four years. The administration and Legislature could use surplus/excess State General Fund money to cover some or all of the Priority 5 over-commitment.

By allowing politics to dominate the capital outlay process, spending flexibility for future years is limited. Instead, rational and objective project selection criteria should be developed and a better balance of executive and legislative authority should be established – both for capital outlay projects that are currently funded and those receiving commitments for future-year funding. To prevent over-commitments and enable the state’s construction spending program to respond to changing state needs, limits should be put on the project queue.

The following recommendations should be a part of comprehensive capital outlay reform. In light of the estimates that no new projects can be funded for four years due to the over-commitment problem, a complete capital outlay overhaul following the current legislative session is in order. A special legislative session should be convened to re-establish the state’s capital outlay priorities under a reformed selection process that balances executive and legislative concerns. Instead of allowing each of the currently slated projects to be funded through to completion, the Legislature should cancel all funding for any project that is not already under contract. The goals and priorities of the new governor and new Legislature should guide the state’s construction spending in the coming years.

Solving the Over-Commitment Problem

1. Develop a realistic capital outlay program that limits future-year commitments to the amount of cash flow the state expects to have available for project expenditures. This would prevent the over-commitment problem. The lack of a statutory

limit on how much bond funding can be included in the capital outlay bill is significant because, while there is no limit on the bond funding that can be included in the bill, there is an unofficial limit on how much of that bond funding can be made available for projects each year. Since there is never enough bond funding available to fund every project included in the bill that the Legislature sends to the governor, the governor gets to decide which bond-funded projects to submit to the State Bond Commission for lines of credit after the legislative session ends.

The projects in the bill are categorized into five priority levels, which offer somewhat of a guide regarding which projects actually will be funded first. Priority 1 is limited to the reauthorization of prior year lines of credit or Higher Education

Desegregation Settlement Agreement projects. Legislators cannot add just anything to Priority 1. Currently, legislators can add to priorities 2, 3, 4 and 5 without limit. Priority 1 guarantees funding in the current year, and priorities 2 and 5 serve as a state promise for future funding as soon as it is available. The waiting list is currently several years long. A Priority 2 cash line of credit can be spent in the same fiscal year that it is granted. A Priority 5 non-cash line of credit usually means funding will be granted in future years.

Limitations should be placed on the total cost of projects listed in the priority categories to force the Legislature into choosing which projects will receive funding when. Because some projects are consistently delayed or canceled, some degree of over-programming should be allowed to enable proper cash flow management. Around 20 percent of projects with cash lines of credit in priorities 1 and 2 are either delayed or canceled each year.

Priority 2 should be limited to the annual capacity for new debt (\$350 million for fiscal year 09) after obligations in Priority 1 are satisfied. This would prevent the Legislature from continuing to abrogate its responsibility to choose projects and force a more thoughtful evaluation of the comparative merits of each. Priority 3 would serve as the reservoir for projects when those in the top two categories are delayed or canceled.

The Priority 5 non-cash line of credit commitment is essentially a promise (a foot in the doorway) to provide funding for project cash flow, not in the current year, but in future years.

Further, because some projects only require partial funding in a particular year, it is important that the bill plan for projects several years out to make best use of all cash available in a year and to ensure that future years' budgets are not completely over-committed. The Priority 5 non-cash line of credit is basically a promise from the state to provide cash in the subsequent fiscal year, and it provides legal authority to award construction contracts for more than the cash flow available in the current fiscal year. But this priority category should be limited to containing a list of projects valued at a maximum cost of 40 percent of the value of projects in Priority 1. This would prevent over-commitment of future budgets.

2. Place in statute the limit on new debt available for cash lines of credit for capital outlay projects.

The unofficial limit that has been respected since 1994 was set at \$200 million adjusted annually for construction inflation (\$350 million for fiscal year 09). This restriction was put into place as a means of keeping the state's annual debt payments under a separate constitutional limit on debt service. The Constitution limits annual debt payments to 6 percent of revenues (just over \$693 million in fiscal year 09). While there is some debate about which debt payments must be included in the 6 percent calculation, current projections show that the state could hit its constitutional limit on debt service within the next 10 years. Those projections must be considered as the state decides how much new debt to issue each year. A statutory limit on new debt issuance for capital outlay would put in place an important prevention against overburdening future budgets.

Limiting the Governor's Power

3. Incorporate legislative committees into the post-session process of deciding which projects will be sent to the Bond Commission for lines of credit. The Legislature, in effect, "nominates" projects seeking to be granted Priority 2 new cash lines of credit or Priority 5 new non-cash lines of credit for Bond Commission approval by including them in those categories of the bill. But by loading up the bill with more projects than can be funded, the Legislature forces a post-session decision-making

process controlled by the governor who decides which projects to recommend to the Bond Commission. Those decisions instead should be made by the Joint Legislative Committee on Capital Outlay. The Joint Legislative Committee on Capital Outlay is a 43-member committee composed of the members of the four legislative committees that deal with the capital outlay budget, the speaker of the House and four of his appointees, and the president of the Senate and four of his appointees. The committee also includes the chairman of the Joint Legislative Committee on Transportation, Highways, and Public Works.

The governor still would have significant control over final funding decisions. The governor, the commissioner of administration and the governor's handpicked legislative leaders account for 10 of the 14 Bond Commission member votes.

The cost of outstanding projects that had been promised funding in last year's capital outlay budget was more than twice what it has been in any single year in at least the previous 12 years, and is probably the highest it has ever been in capital outlay history.

4. Shift responsibility for developing the five-year capital outlay program from the governor to the Joint Legislative Committee on Capital Outlay. This committee could provide a mechanism for transparency and public participation, which is currently missing in the development of the capital outlay budget the governor submits to the Legislature. In the mid-1980s, this committee held public hearings, allowed public testimony and developed budget recommendations separate from those developed by the governor.

Now, the committee's role is reduced to meeting one time per year to grant approval for late capital outlay requests submitted after the Nov. 1 statutory deadline.

Require regional public hearings to be conducted by the Joint Legislative Committee on Capital Outlay as part of the development of the capital outlay budget. This process would document the priorities of each region of the state. Regional chambers of commerce, regional economic development organizations and regional planning districts should be encouraged to participate.

Limiting the Draw of Non-State Projects

5. Revise the capital outlay request forms to require applicants to provide a thorough feasibility study or cost/benefit analysis. The Office of Facility Planning and Control should assist in the analysis for small projects for which a formal feasibility study would be unaffordable. Final determination on whether a project is feasible or of sufficient public benefit should be left to the Joint Legislative Committee on Capital Outlay. Rational and objective standards should be developed to define the types of projects that will be given consideration. The standards and policies for evaluation should be developed jointly by the capital outlay committee and facility planning staff.

6. Require a 25 percent match for non-state entity projects and a means by which to grant exceptions. Exceptions should be granted for projects that are deemed an emergency needed to protect the health and safety of citizens or that offer other substantial statewide or regional benefit. Match waivers should only be granted when the entity is certified by the legislative auditor as being unable to pay.

7. Limit non-state entity projects to 25 percent of the new cash line of credit capacity made available each year. The non-state entities' share of capital outlay funding has typically ranged from 20 percent to 30 percent per year, but in some years it has been as high as 40 percent. Setting this limit would encourage a more rational and competitive process for determining which local projects to fund.

8. Set aside \$100 million of state revenues to start a Revolving Loan Fund for non-state entity capital projects. The projects in this program would be appropriated in the capital outlay budget just like the regular capital outlay program, but this would be a means of financing separate from traditional capital outlay bond funding. This program could start as an alternative for non-state entities that are able and willing to pay back the funding at a low interest rate and could grow to a self-sufficient grant and loan program for all non-state capital outlay projects. With continued state investment over the next 20 years, the Revolving Loan Fund gradually would phase out non-state entities from the competition with state agencies for state bond funding. A portion of the fund would be set aside to be distributed as grants for projects of merit that have no capacity to repay the capital.

9. Remove the Joint Legislative Committee on Capital Outlay from the late request submission approval process. This would mean that any capital outlay request submitted after Nov. 1 would have to be justified as an economic development project or an emergency project needed to protect life or property.

10. Prohibit state agencies, such as higher education institutions, from bypassing the capital outlay process and going directly to the State Bond Commission to get approval to issue bonds for construction projects. These bonds count against the constitutional debt limit and should be required to go through the capital outlay process for legislative approval or at least be required to be approved by the Interim Emergency Board mail ballot process so that the entire Legislature can approve or reject such projects before bonds are issued and thereby commit the state to pay the debt service.

Conclusion

While various "reform" proposals are floated every year, this year the push for change is being embraced by a wider range of stakeholders. The governor issued an executive order calling for certain capital outlay reforms and submitted a budget that contained no new projects. In addition, several legislative leaders have put their names on bills seeking various reforms. Unfortunately, most of these approaches appear to do more to consolidate and strengthen the governor's control over the process than to effect real reform. While some proposals currently under consideration would make some effort to rein in the governor's power over project selection, none would implement several other important changes to the process outlined in this research brief.

The state's current capital outlay process is highly politicized and dominated by back-room deals made for short-term goals but with long-term implications. The only way to fix the problem is to undertake a complete overhaul of the process that limits the governor's power, prevents over-committing future state budgets and develops an alternate means of funding for non-state projects that removes them from competition with state projects.

**For more information, go to
www.la-par.org
to read PAR's background paper
"Louisiana's Capital Outlay Process."**