

**TITLE:** 2024-2026 Postsecondary Education Budget Recommendation  
Postsecondary Institution Capital Investment Request

**DESCRIPTION:** The Finance Committee recommends the Council approve the proposed 2024-2026 Postsecondary Institution Capital Investment Request.

**PRESENTER:** Eric Farris, Chair of the Finance Committee

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### **COMMITTEE REVIEW & APPROVAL**

The Finance Committee reviewed and approved the Postsecondary Institution Capital Investment Request during its September 11, 2023, meeting. A summary of the requests approved were:

- Appropriations of \$6,532,000 in 2024-25 and \$13,064,000 in 2025-26, recurring at the latter amount in subsequent years, to pay annual debt service on \$162,370,000 in state bonds, requested in 2024-25, to help offset construction cost increases on individual new and expanded space projects authorized for postsecondary institutions during the 2022-2024 biennium.
- Capital appropriation to each institution equal to 20% of the bond funds it received in the 2022-2024 biennium for line-itemed capital projects, which will allow Kentucky colleges and universities to complete new capital construction projects as originally envisioned.
- Budget bill language to allow institutions flexibility to apply any unused construction cost increase funds to pressing asset preservation needs.
- Appropriation of \$14,078,000 in 2024-25 and \$42,233,000 in 2025-26, recurring at \$56,312,000 in subsequent years, to pay annual debt service on \$700 million in state bonds (i.e., \$350 million each year) to finance asset preservation and renovation projects at public postsecondary institutions during the upcoming biennium.
- No institutional match of state funds be required of any postsecondary institution to allow projects to proceed as quickly as possible and to reduce any further strain on campus operating budgets.
- Budget bill language, similar to the language in HB 1 (2022 RS), that would allow asset preservation pool funds to be used to preserve and maintain state-owned and operated residence facilities.

## **SUPPORTING INFORMATION**

This agenda item contains a detailed staff recommendation regarding the level of state investment required to address public postsecondary institution new construction, asset preservation, and information technology and equipment project needs for the upcoming 2024-2026 biennium. It identifies the most pressing campus needs to offset construction cost increases for new and expanded space projects authorized in 2022-2024, renovate and renew existing facilities, and finance information technology and equipment projects (using institutional resources).

### **Background**

In 2005, the Council and postsecondary institutions contracted with Vanderweil Facilities Advisors, Inc. (VFA), Paulien & Associates, and NCHEMS to conduct a comprehensive review and assessment of Kentucky's public college and university facilities. Evaluators took more than a year and examined over 700 Education and General (E&G) facilities located on college campuses across the system and, in early 2007, concluded that Kentucky's facilities inventory was in relatively poor condition compared to industry standards.

Most buildings at that time were over 30 years old and their condition and utility was consistent with their age. Additionally, HVAC, plumbing, and electrical systems in many buildings had far exceeded their useful life expectancies and many buildings no longer adequately supported the academic programming for which they were originally intended. Overall, evaluators identified an accumulation of about \$6.1 billion in asset preservation needs for the postsecondary system projected to come due by 2018 (*Facility Condition Assessment & Space Study*, VFA, 2007).

In 2013, VFA evaluators were retained again by the Council and updated their findings from the 2007 study. Based on updated projections, they determined that unless sizable investments in asset preservation were made in coming biennia, the magnitude of renovation and renewal need would grow to \$7.3 billion by 2021. A combination of factors, including a growing inventory of aging facilities, infrastructure, and building systems in need of renovation and renewal, increasing construction costs, and minimal state investment in asset preservation, contributed to growth in perpetuation need.

### **2024-2026 Capital Investment Recommendation**

The Council's capital investment request typically includes three components: (a) new construction; (b) asset preservation; and (c) information technology and equipment. In recent biennia, due to sizable, accumulated needs for facilities renovation and renewal on college campuses, CPE staff and campus officials have elected to prioritize asset preservation in the capital request. This focus was operationalized by requesting large additional appropriations for asset preservation, while at the same time requesting no funding for new and expanded space projects or for information technology projects.

Stakeholders propose that a similar approach be used in 2024-2026. As can be seen in Table 1 below, CPE staff and campus officials recommend that the Council include in its budget recommendation requests for \$350 million each year of the upcoming biennium (or \$700 million in total) to finance asset preservation projects at Kentucky colleges and universities, which could be either cash or bond funded. If the General Assembly elects to issue bonds to finance the request, the estimated debt service would be \$14,078,000 in fiscal year 2024-25 and \$42,233,000 in 2025-26 (determined using Finance Cabinet debt service calculator).

**Table 1: Components of 2024-2026 Capital Investment Request**

Funding Category	Fiscal 2024-25	Fiscal 2025-26	Biennial Total
New Construction	\$0	\$0	\$0
Construction Cost Increases	\$162,370,000	\$0	\$162,370,000
- Debt Service	6,532,000	13,064,000	19,596,000
Asset Preservation	\$350,000,000	\$350,000,000	\$700,000,000
- Debt Service	14,078,000	42,233,000	56,311,000
Information Technology and Equipment	\$0	\$0	\$0

The asset preservation debt service estimates represent a half year of debt service on \$350 million requested in the first year of the biennium (i.e., the 2024-25 debt service figure) and a full year's debt service on that same \$350 million assessed in the second year, plus a half year's debt service on the additional \$350 million requested in the second year (i.e., the 2025-26 debt service figure). This method for ascertaining and requesting debt service has been used by CPE staff over many biennia.

In addition to the asset preservation component, CPE staff and campus leaders also propose that the Council include a request for \$164.2 million in the first year of the biennium (i.e., 2024-25) to help offset construction cost increases on individual capital projects that the General Assembly authorized for implementation in the current biennium (i.e., 2022-2024). Like asset preservation, this request also could be cash or bond funded. If bonds are issued to finance the request, the estimated debt service would be \$6,532,000 in fiscal year 2024-25 and \$13,064,000 in 2025-26 (again determined using the Finance Cabinet debt service calculator).

In keeping with the approach used in recent biennia, postsecondary stakeholders propose that the Council's capital investment request include a large ask focused on renovation and renewal of existing facilities, but not include requests for new construction or information technology projects. While investment in such projects is important for many institutions, CPE staff and campus officials recommend that the Council's 2024-2026 capital investment request focus on

asset preservation and construction cost increases. These components are described in greater detail below.

### New Construction

For the 2024-2026 biennium, CPE staff and campus leaders agree that a request for state bond funds (or cash) supporting new and expanded space should not be included in the Council's capital investment recommendation. However, as was the case in recent biennia, institutions will be free to submit to the Governor and General Assembly their own requests for new construction projects and to advocate for those requests.

### Construction Cost Increases

Early in the budget development process for 2024-2026, campus chief budget officers and presidents communicated to CPE staff that funding for individual capital projects authorized in the current biennium would not be sufficient to fully fund the original scopes of the projects due to rapidly rising construction costs. A convergence of factors such as tariffs on imported goods, the impact of COVID-19 on global supply chains, escalating costs of building materials, worker shortages and rising labor costs, and higher interest rates, led to increases in construction costs not seen in 40 years.

CPE staff surveyed campus officials to determine the extent of construction cost inflation on new and expanded space projects at Kentucky colleges and universities between the time when institutions submitted their six-year capital plans (i.e., November 2021) and project funding was authorized (April 2022) and the time when institutions could actually begin spending on the projects (i.e., July 2023). This lag time occurred because the General Assembly authorized all but one of the new and expanded space projects in the second year of the biennium (i.e., fiscal year 2023-24). Institutions responded that construction costs had increased between 20% and 33% during that period and they would not be able to fully fund those projects at their original scopes. Using a CBRE Index developed by Coldwell Banker, CPE staff confirmed that commercial real estate construction costs increased by 31% during this period.

To address escalating construction costs, CPE staff and campus officials recommend that the Council include a request for \$162.4 million in bond funds (or cash) in its capital investment recommendation, which would allow institutions to offset unprecedented inflationary cost increases on individual capital projects authorized in the 2022-2024 biennium. The full amount should be requested in the first year of the biennium (i.e., fiscal year 2024-25) to facilitate completion of projects already underway. Specifically:

- *Staff recommends appropriations of \$6,532,000 in 2024-25 and \$13,064,000 in 2025-26, recurring at the latter amount in subsequent years, to pay annual debt service on \$162,370,000 in state bonds, requested in 2024-25, to help offset construction cost increases on individual new and expanded space projects authorized for postsecondary institutions during the 2022-2024 biennium.*

If authorized, these funds will allow institutions to maintain the original scope of projects approved by the General Assembly in the current biennium (i.e., no scaling back, or phasing of projects). Staff recommends allocation of these funds as shown in Table 2.

**Table 2: Allocation of Construction Cost Increase Request**

Campus	Individual Capital Projects	Bonds Authorized in 2022-2024	Construction Cost Increases @20%
UK	Construct Health Education Building	\$250,000,000	\$50,000,000
UofL	Construct Multidisc Engineering Building	65,000,000	13,000,000
EKU	Construct New Model Lab School	90,000,000	18,000,000
EKU	Renovate Alumni Coliseum	31,350,000	6,270,000
KSU	(No individual projects funded)	0	0
MoSU	Construct Science & Engineering Building	98,000,000	19,600,000
MuSU	Construct Nursing School & Health Building	45,500,000	9,100,000
NKU	Expand Hermann Science Center	79,900,000	15,980,000
WKU	Construct Gordon Ford College of Business	74,400,000	14,880,000
KCTCS	Construct Classroom - BCTC Newtown	52,200,000	10,440,000
KCTCS	Expand Leitchfield Campus - Etown CTC	9,000,000	1,800,000
KCTCS	Renovate Occup Technical Building - ECTC	16,500,000	3,300,000
Total Bond Funds & Cost Increase Request:		\$811,850,000	\$162,370,000

The requested funds represent 20% of \$811.9 million in bond funds authorized for new construction projects in the 2022-2024 biennium. All institutions, with the exception of KSU, received funding for at least one capital project. EKU received funding for two projects (one being a new Model Laboratory School) and KCTCS received funding for three projects. CPE staff and campus officials agreed on a 20% allocation. Specifically:

- *CPE staff recommends a capital appropriation to each institution equal to 20% of the bond funds it received in the 2022-2024 biennium for line-itemed capital projects which will allow Kentucky colleges and universities to complete new capital construction projects as originally envisioned.*

If additional funds, over and above the 20% allocation requested, are required to fully fund the projects, institutions will have to find other sources of revenue to finance the projects or scale them back in some way. If some portion of the additional appropriation is not required for an institution to complete a project, CPE staff recommends that budget bill language be included to allow the institution to apply unused funds to asset preservation projects. Specifically:

- *CPE staff recommends that budget bill language be included to allow institutions flexibility to apply any unused construction cost increase funds to pressing asset preservation needs.*

## Asset Preservation

Asset preservation refers to college and university expenditures that preserve, renovate, and renew Education and General facilities in order to extend their useful life, bring them up to industry standards, and otherwise support the public service, research, and instructional missions of the institutions. The term “facilities” includes buildings, building systems, and campus infrastructure, such as roads, walkways, electrical grids, steam tunnels, and water chiller plants. In the *2022-2024 Budget of the Commonwealth* (HB 1, 22 RS), the definition of asset preservation was expanded to include expenditures for state-owned and operated residential housing facilities.

As indicated in the background section above, VFA Study researchers found that the cumulative cost of bringing Kentucky’s postsecondary education facilities up to industry standards would exceed \$7.3 billion by 2021. Between 2008 and 2022, renovation and renewal needs were not addressed in any substantive way by either the institutions or the state. In the 2022-2024 biennium, the General Assembly appropriated \$700 million (\$350 million each year) to institutions to finance asset preservation projects, the first significant investment in asset preservation in more than a decade. CPE staff, Council members, and campus leaders are all very appreciative of that investment.

CPE staff’s asset preservation recommendation for 2024-2026 is intended to maintain momentum and build upon the success of the prior biennium by requesting a second installment of \$700 million for renovation and renewal. Specifically:

- *Staff recommends an appropriation of \$14,078,000 in 2024-25 and \$42,233,000 in 2025-26, recurring at \$56,312,000 in subsequent years, to pay annual debt service on \$700 million in state bonds (i.e., \$350 million each year) to finance asset preservation and renovation projects at public postsecondary institutions during the upcoming biennium.*

If the asset preservation request is approved by the Council and authorized by the General Assembly, CPE staff recommends that the funds be allocated among institutions using the same approach used by the General Assembly to allocate funds appropriated in the 2022-2024 biennium, which distributed funds based on each institution’s share of system total Category I and II square feet. The recommended allocation of requested asset preservation funds is shown in Table 3.

**Table 3: Allocation of Asset Preservation Request**

Campus	Category I & II Square Feet	Percent of Total	Fiscal Year 2024-25	Fiscal Year 2025-26	Biennial Total
UK	6,839,710	24.10%	\$84,351,000	\$84,351,000	\$168,702,000
UofL	3,412,420	12.02%	42,084,000	42,084,000	84,168,000
EKU	2,322,080	8.18%	28,637,000	28,637,000	57,274,000
KSU	673,771	2.37%	8,310,000	8,310,000	16,620,000
MoSU	1,429,727	5.04%	17,632,000	17,632,000	35,264,000
MuSU	1,998,068	7.04%	24,641,000	24,641,000	49,282,000
NKU	1,964,608	6.92%	24,229,000	24,229,000	48,458,000
WKU	2,659,023	9.37%	32,792,000	32,792,000	65,584,000
KCTCS	7,080,808	24.95%	87,324,000	87,324,000	174,648,000
Total	28,380,215	100.00%	\$350,000,000	\$350,000,000	\$700,000,000

Staff further recommends that any appropriations for asset preservation in the upcoming biennium be allocated to the institutions in funding pools. Each campus has provided a list of high-priority renovation and renewal projects that could be financed using funds from their respective pools. A list of each institution’s asset preservation projects can be found in Attachment C-1. In the current biennium, only asset preservation projects that address the needs of Education and General facilities and state-owned and operated residence halls are eligible to be financed using asset preservation pool funds.

Unlike the current biennium (i.e., 2022-2024), when research institutions (UK and UofL) were required to match each state dollar of asset preservation funds with 30 cents of campus funds, and comprehensive universities and KCTCS were required to match each state dollar of asset preservation funds with 15 cents of campus funds, staff is recommending no match for any postsecondary institution of any asset preservation funds provided by the state in the upcoming biennium. Specifically:

- *Staff recommends that no institutional match of any state funds be required of any postsecondary institution to allow project to proceed as quickly as possible and to reduce any further strain on campus operating budgets*

If this recommendation is adopted by the Council and followed by the General Assembly, it will allow institutions to initiate projects more quickly and alleviate strain on campus budgets by allowing projects to proceed without a required match.

Language included in the 2022-2024 enacted budget (HB 1, 22 RS) specified that asset preservation pool funds could be used to renovate and renew state owned and operated residential housing facilities. This represented a new approach on the part of the General Assembly, which previously had limited the use of asset preservation funds to E&G facilities. In light of this new direction, CPE staff and campus officials support continuation of the increased flexibility and ask that the Council recommend inclusion of budget language allowing asset

preservation funds to be used for both E&G facilities and state-owned residence hall projects. Specifically:

- *Staff recommends that the Council's capital investment recommendation include a request for budget bill language, similar to the language in HB 1 (2022 RS), that would allow asset preservation pool funds to be used to preserve and maintain state-owned and operated residence facilities.*

As previously mentioned, CPE staff, Council members, and campus leaders are all exceedingly grateful for the state's \$700 million investment in 2022-2024 to preserve existing postsecondary facilities. What is needed at this point is a second installment of that investment. The magnitude of the problem is great, estimated to be in excess of \$7.0 billion, given recent increases in construction costs. Sustained investment over an extended time horizon is needed to address what has become an overwhelming and urgent need to preserve and protect these valuable state-owned assets.

If the recommendations in this section are adopted by the Council and authorized by the General Assembly, there is hope that these funds will mark the beginning of a long-term partnership between the state, postsecondary institutions, and students and families to address the system's substantial asset preservation needs.

#### Information Technology and Equipment

For the upcoming biennium, CPE staff is not recommending a capital investment request to support information technology or equipment projects. Compared to other funding components, information technology was less of a priority among CPE staff, campus presidents and CBOs, than other funding components. However, institutions will be free to submit to the Governor and General Assembly their own requests for information technology and equipment projects.

#### **Institution Funded Projects**

Staff recommends that the Council approve institutionally funded capital projects that further the goals of *The Postsecondary Education Improvement Act of 1997* (HB 1) and objectives of the Council's *2022-30 Strategic Agenda*. While this proposal requests state funds for asset preservation only, the state budget office has allowed the institutions to submit their projects using the fund source that they used in the capital planning system. The state budget office is fully aware of the CPE position.

Council approval of projects listed in the attachments that are not included in the enacted biennial budget may be pursued in the interim using institutional resources as allowed without additional Council approval. Staff recommends that the Council support projects in the following categories:

- *Authorization of \$7,543,180,000 in agency, federal, private, and other fund source authority to address asset preservation projects on postsecondary campuses during the*

*upcoming biennium. This authorization level represents the total of all possible agency, federal, private, and other fund source financed asset preservation projects that might be undertaken by the campuses during the biennium. These projects can be found in Attachment C-1.*

- *Authorization of \$6,858,051,000 in agency, federal, private, and other fund source authority to address new and expanded space on postsecondary campuses during the upcoming biennium. This authorization level represents the total of all possible agency, federal, private, and other fund source financed new and expanded space projects that might be undertaken by the campuses during the biennium. These projects can be found in Attachment C-2.*
- *Authorization of \$714,855,000 in agency, federal, private, and other fund source authority for information technology needs on postsecondary campuses during the upcoming biennium. This authorization level represents the total of all possible agency, federal, private, and other fund source financed projects that might be undertaken by the campuses during the biennium. A list of these projects can be found in Attachment C-3.*
- *Authorization of \$11,430,000,000 in agency, federal, private, and other fund source authority to address non-Information Technology UK Healthcare capital projects. These projects can be found in Attachment C-4.*
- *Authorization of capital leases. Funding for these leases is included in the institutions' operating budgets. These leases can be found in Attachment C-4.*
- *Authorization for guaranteed energy efficiency projects in campus buildings, including energy equipment acquisitions, infrastructure repair, and upgrades. These projects would be funded using third-party financing available through the Finance and Administration Cabinet, private contractors, or other non-state funds.*

## **Endorsements**

Staff recommends that the Council endorse the following language for inclusion in the 2024-26 Budget of the Commonwealth:

*Inasmuch as the identification of specific projects in a variety of areas of postsecondary institution operations cannot be ascertained with absolute certainty at this time, amounts are appropriated and authorized for specific projects which are not individually identified in this act in the following areas: EKV, KCTCS, KSU, MoSU, MuSU, NKU, UK, UofL, and WKU asset preservation, renovations, major maintenance, infrastructure, and HVAC and roofing systems.*

*Any specific project to be included in the asset preservation pool exceeding \$1,000,000 or any major item of equipment exceeding \$200,000 that is initiated shall be reported by the institution to the Council on Postsecondary Education, the Secretary of the Finance and*

*Administration Cabinet, and the Capital Projects and Bond Oversight Committee no later than 30 days after the specific project or equipment item is initiated and funded. The report shall identify the need for, and provide a brief description of, each project or equipment item pursuant to KRS Chapter 45.*