

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

April 17, 2007

The Capital Projects and Bond Oversight Committee met on Tuesday, April 17, 2007, at 1:00 PM, in Room 169 of the Capitol Annex. Senator Elizabeth Tori, Co-Chair, presided over the meeting, and the secretary called the role.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senators Tom Buford, Jerry Rhoads, and Dan Seum; and Representatives Robert Damron, Steven Rudy, and Jim Wayne.

Guests testifying before the Committee: Dr. Randy Dunn, Tom Denton, and Bob Jackson, Murray State University; Senator Ken Winters and Representative Melvin Henley; John Osborne, Western Kentucky University; John Hicks, Governor's Office for Policy and Management; Jim Abbott and Nancy Brownlee, Finance and Administration Cabinet; Jerry Miller, Department of Parks; Sandy Williams, Kentucky Infrastructure Authority; and Terri Fugate and Tom Howard, Office of Financial Management.

LRC Staff: Nancy Osborne, Shawn Bowen, Bart Hardin, Kristi Culpepper, and Lesa Prewitt.

The meeting was called to order by Nancy Osborne, Committee Staff Administrator. Ms. Osborne then asked for a moment of silence in memory of the students and staff who lost their lives in the tragedy at Virginia Tech.

Representative Damron made a motion to approve the minutes of the March 20, 2007 meeting. The motion was seconded by Senator Seum and passed by voice vote.

Ms. Osborne said the Committee would hold elections today for new Senate and House Co-Chairs as the Senate and House Leadership has made new appointments and reappointments to statutory committees.

Ms. Osborne opened the floor for nominations for Committee Co-Chair (Senate). Senator Seum nominated Senator Elizabeth Tori to serve as Committee Co-Chair. The nomination was seconded by Senator Rhoads.

Senator Seum made a motion that the nominations be closed and that Senator Tori be elected as Committee Co-Chair by acclamation. The motion was seconded by Senator Rhoads, and Senator Tori was elected by acclamation.

Ms. Osborne opened the floor for nominations for Committee Co-Chair (House). Representative Wayne nominated Representative Mike Denham to serve as Committee Co-Chair. The nomination was seconded by Representative Damron.

Representative Rudy made a motion that the nominations be closed and that Representative Denham be elected as Committee Co-Chair by acclamation. The motion was seconded by Representative Damron, and Representative Denham was elected by acclamation.

Ms. Osborne reviewed the correspondence and information items included in the members' folders. She said quarterly construction reports from the Administrative Office of the Courts, the Finance and Administration Cabinet, Murray State University, University of Kentucky, University of Louisville, and Western Kentucky University were submitted this month for the Committee's review. She noted that projects with significant changes would now be highlighted for the Committee's review. As such, she reported that the Lincoln Homestead project, which received funding from the 2004-06 Parks Renovation Pool, is now in construction. The University of Louisville (UL) which used the Construction Management-at-Risk project delivery method for the Belknap Campus Research Building project (2000-02 budget; \$41,368,000 Agency Bonds and State Bonds) has received \$332,000 representing the unused portion of the Guaranteed Maximum Price from the construction manager. UL will use these funds for equipment for the research facility.

Other items included correspondence from the Division of Historic Properties relating to the window replacement project at the Executive Mansion, from the Department of Labor relating to prevailing wage, from the Department of Aviation relating to the state's air fleet, and from the Department of Parks relating to Green River Lake State Park Campground.

Ms. Osborne said the information items included the monthly Staff Update of various capital projects, enacted legislation relating to the jurisdiction of the Capital Projects and Bond Oversight Committee, and the updated monthly and weekly debt issuance calendar.

Ms. Osborne briefly discussed articles included in the Staff Update. She noted that Northern Kentucky University is moving forward with the purchase of the Lakeside Heights Nursing Center and plans to renovate it for dormitory space; Requests for Proposals (RFP) were issued to solicit private sector development of amenities for General Burnside Island State Park and for Mineral Mounds; and the Council on Postsecondary Education has released the results of a Facilities Assessment Report of state postsecondary institutions.

Representative Wayne said at the Committee's March meeting it was reported that a ruling had been issued by the Department of Labor regarding the prevailing wage requirements in the RFP issued to solicit private development of a lodge and golf course at the Green River Lake State Park. He asked Jim Abbott, Commissioner, Department for Facilities and Support Services, if the Department of Labor had actually made this ruling in March. Mr. Abbott responded that the statement he made last month that the Department of Labor had made a ruling regarding prevailing wage was relative to what he read in a number of emails and in discussions between the Finance Cabinet and the Department of Parks. However, at that time, the Department of Labor had not issued anything in writing concerning this policy.

Representative Wayne said the determinations by the Department of Labor, which the Committee received in its packet this month, were dated April 3 and April 11. He said this policy will affect many working Kentuckians, and it may be necessary to seek an opinion from the Attorney General (AG). He referred to the Hardin Memorial Hospital, Inc. v. Land decision, the only Kentucky case cited by the Department of Labor relating to the issue of prevailing wage, and said this court decision does not appear to support the Department's ruling. He said it is imperative to get an opinion from the AG and hopefully the labor community would clarify the law by challenging this in court.

Representative Wayne next asked Mr. Abbott if any documentation had been made regarding privatization of the projects at the state parks. He referred to KRS 45A.550 - 45A.554, the statutes governing the procedures for state agency privatization contracts, and said before a state agency recommends to the Finance and Administration Cabinet that it enter into a privatization contract, the state agency shall determine and set forth in writing the necessity for the service and the intended goals of the service, problems and inefficiencies existing with the current governmental operation of the service, and whether the service can efficiently be provided by the agency.

Jerry Miller, Commissioner, Department of Parks, asked to be recognized. He said the privatization statute does not apply in this case, as it is impossible to privatize operations that do not exist. He explained that a lodge, a golf course, and a restaurant do not exist at Green River nor at General Burnside. He added that the statutes require that the state make an effort to place displaced employees in vacant positions in another state agency and retrain employees for other positions in state government. In this case, there are no employees so there is no displacement.

Representative Wayne said this statute has been in place since 1998 and it provides guidelines for privatization. Mr. Miller responded that the Department of Parks was attempting to enter into a public-private partnership where a developer would pay to provide a tourist opportunity with private funds. He said the private investor and not the state will bear any operating losses that typically occur in the early years of operating such facilities.

Representative Wayne said it was questionable whether the state has the right to start a new venture at the state park by privatizing it. He said by privatizing this project, the Department of Parks is by-passing the existing method for operating a state park.

Mr. Miller said the Department of Parks is following a precedent set by previous administrations, and operates at least seven marinas using the same approach as being used for the Green River project. Representative Wayne said in his opinion, the Department of Parks procedures and policies will result in a legislative debate, as well as a court challenge. Mr. Miller stated that the marinas at Lake Cumberland and Lake Barkley were built with private dollars. The developers of the Lake Barkley marina pay the Department of Parks a ground rent of \$36,000 dollars a year and 5% of the gross revenue which supports the operation of that park.

Senator Tori said the issues of prevailing wage and privatization do not directly pertain to the jurisdiction of the Capital Project and Bonds Oversight Committee, and suggested that the Committee's concerns be shared with the appropriate standing committees. Representative Wayne said he thought referring these issues to other committees to further discuss the issues was appropriate. He said in terms of oversight though, the Committee was led to believe that there was a Department of Labor ruling on prevailing wage last month and that was not the case. The question of whether the privatization statutes apply is also outstanding. He said these issues needs to be brought to the public's attention.

Senator Tori noted that a request has been made by the AFL-CIO to the Attorney General to review the prevailing wage issue. She suggested that a meeting be set up with the Committee Co-Chairs, Representative Wayne, and Mr. Miller to further discuss this issue.

Mr. Abbott noted for the record that there have been a number of RFP's issued by prior administrations and that this is not a new process. The current effort is basically due to expressions of interest by the private sector to look at opportunities that these projects present to the developer and which benefit the general public, whether it is a supplemental activity or a new activity created for that area of the state.

Representative Wayne requested the statutorily required documentation for the proposal to privatize the Green River State Park project. Mr. Miller said this statute does not apply. He noted that the legislature had discussed this issue in a past session and Representative Robin Webb introduced a bill to alter that statute to make it apply to any operation. He said to his knowledge the bill did not make it out of committee.

In response to a question from Representative Damron, Mr. Miller said if this project results in a contract with a private developer, it would be constructed in the same

manner as proposed for the new Horse Park hotel and the various existing privately developed marinas at State Parks.

Representative Damron said he understood that the state had a history of entering into agreements with private entities in order to provide amenities. He said the reason for doing this is the Legislature did not feel it appropriate to sell state bonds to provide for those investments. He said he did not think the privatization statutes applied in this case, as this is a way to encourage private sector investment in state parks and make the state parks more marketable to the general public.

Senator Buford referred to the proposed Horse Park hotel and said he understood the statutes allow the state to solicit private investment for developments at the Horse Park and State Parks.

Senator Tori next asked representatives of Murray State University (MuSU) to discuss a request for a scope increase for the MuSU New Science Complex project. Guests testifying were Dr. Randy Dunn, President, MuSU; Tom Denton, Vice-President for Finance and Administration, MuSU; and Bob Jackson, Associate Vice-President for Institutional Advancement, MuSU. Senator Ken Winters and Representative Melvin Henley also joined University representatives at the table.

The MuSU New Science Complex, Phase II, was authorized in the 2004-06 budget at a scope of \$15,000,000 (state bond funds). Dr. Dunn said the University is now requesting a scope increase of \$2,650,000 to complete shell space on the second floor of the Biology Building and to "dry in" the Chemistry Building. The scope increase will be funded with \$2,250,000 from the University's contingency funds (restricted funds) and \$400,000 in private cash donations.

Dr. Dunn explained that the University was working under the Phase II appropriation and realized the money was not sufficient for completion of the Chemistry Building. He said the 2006-08 budget provided \$15,000,000 (state bond funds) for the Phase III for the Physics Building. He noted the 2005 General Assembly provided that the Phase II appropriation is to be used to supplement Phase I work on the Biology Building.

Dr. Dunn said the requested scope increase will allow the University to continue construction of this project. He said they plan to seek a legislative budget language change so the Phase III appropriation can be used to continue the work on the Chemistry Building, as well as to begin work on the Engineering and Physics Building. MuSU will also seek legislative approval to use the Phase III money to reimburse MuSU's contingency fund. Dr. Dunn said the University Board of Regents met on April 13, and agreed to approve an increase in the project scope for this project.

Dr. Dunn said he was not comfortable utilizing this much of the University's contingency funds, but it is in the best interest of the University. He said MuSU took on the responsibility to manage its own construction projects in 1988 and with this authority comes responsibility for the project.

Representative Denham asked how oversight was provided for this project. Dr. Dunn responded that the University has a Facilities Management unit that reports directly to the President of the University.

Representative Denham encouraged all universities, in the face of rising costs, to review oversight on all projects. He also encouraged the universities to review security policies for all facilities.

Representative Denham asked how much work remains to be done on the Chemistry and Biology Buildings. Dr. Dunn responded that if the scope increase is approved today, the second floor of the Biology Building would be completed and ready for occupancy by June 1, and provide funds to "shell in" the Chemistry Building so it appears as a finished building from the street. (The first floor of the Biology Building was accepted in summer 2004.)

Representative Wayne thanked Senator Winters and Representative Henley for joining MuSU representatives at the table. He also thanked Dr. Dunn and welcomed him to Kentucky.

Senator Buford made a motion to approve the scope increase for the New Science Complex at Murray State University. The motion was seconded by Senator Seum and passed by unanimous roll call vote. The revised project scope is \$17,650,000.

Senator Rhoads explained his Yes vote. He said it is unfortunate that these projects are funded in phases and it would seem more advantageous to fund the total project as this would lock in a set dollar amount, and allow the University to move forward with a complete project. He said he thought MuSU was making the best of a tough situation. He added it was timely that this Committee recognized the need to permit MuSU to move forward, especially in light of the Council on Postsecondary Education study which identified billions of dollars worth of capital improvements needed on postsecondary campuses throughout the state.

Representative Denham commended MuSU staff for their hard work on this project and for working cooperatively to keep the project moving in the right direction.

Representative Rudy explained his Yes vote. He said he thought this remedy will provide a temporary solution to the problem, but he was supportive of letting universities control their own money.

Senator Tori next asked John Osborne, Associate Vice President of Campus Services and Facilities, Western Kentucky University (WKU), to discuss a scope increase for the Academic/Athletic #2 (L. T. Smith Football Stadium) Renovation project. The combined budget authorizations from the 2005 and 2006 General Assemblies for this project is \$38,000,000, \$35,000,000 of which is Agency Bonds. The requested scope increase of \$11,781,000 will be funded with \$2,275,000 in restricted funds and \$9,506,000 from private cash donations.

Mr. Osborne said inflation and the cost of construction for the project will consume an estimated \$7 million of the scope increase. The remaining \$4.7 million will be used to add amenities to the project that would otherwise not be possible. The added amenities include a video scoreboard, an end zone berm for outdoor seating and picnic areas, and expanded stadium and clubhouse seating from 17,500 square feet to 23,000 square feet.

Representative Denham asked how the oversight of capital projects is handled at WKU. Mr. Osborne said capital projects are administered by the WKU Planning, Design and Construction Department, which is staffed by engineers and architects. He said this Department reports to him along with the Department of Facilities.

Representative Damron made a motion to approve the scope increase for the WKU project. The motion was seconded by Representative Rudy and passed by unanimous roll call vote. The revised project scope is \$49,781,000.

Senator Tori asked John Hicks, Deputy State Budget Director, Governor's Office for Policy and Management, and Mr. Abbott to present the monthly project report submitted by the Finance and Administration Cabinet.

Mr. Hicks reported an allocation of \$45,000 from the Capital Construction and Equipment Purchase Contingency Account to accommodate a cost overrun on the Kentucky Education Television (KET) Network Center Roof Replacement project. This project was authorized in the 2004-06 budget at a scope of \$1,000,000 (state bond funds). The funds will be used to pay for a change order so more of the perlite roof insulation can be replaced and new isocyanurate roof insulation can be installed.

Representative Wayne made a motion to approve the scope increase. The motion was seconded by Representative Damron and passed by unanimous roll call vote. The revised project scope is \$1,045,000.

In response to a question from Senator Tori, Mr. Abbott said isocyanurate roof insulation is a synthetic material used to insulate roofs. Mr. Abbott explained that had

they not replaced the materials that were wet, there would have been the possibility of mold formation.

Mr. Hicks reported the second of three allocations from the Capital Construction and Equipment Purchase Contingency Account. The Pennyrile Forest State Park Golf Course project was authorized in the 1998-2000 budget at a scope of \$3,000,000 (General Funds), and received a bond allocation of \$468,000 in the 2002-04 budget. During the course of the project, a blue-line stream was inadvertently damaged when the new nine hole golf course was built in 2003, a violation of the Federal Clean Water Act.

Mr. Hicks said the bids to remediate the water quality degradation for this project came in higher than estimated. He said they had reserved a balance of \$303,000 in the renovation project account for repair of the stream, but the remaining balance will not cover the cost of the mitigation project, which is estimated to cost \$518,000.

In response from a question from Representative Rudy, Mr. Hicks responded that this project is in the Louisville Corps of Engineers' district.

Representative Denham made a motion to approve the allocation from the Contingency Account. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote. The revised project scope is \$3,683,000.

Senator Rhoads explained his Yes vote. He said he was glad to see this project before the Committee because this park has been underutilized due to the drainage problems it has experienced. He said now that the problems are being corrected, it should be announced to the public that the problems have been corrected.

Senator Tori asked if Pennyrile Forest State Park golf course continues to operate at a loss. Mr. Miller said that out of 21 golf courses, there were only two or three that had a positive cash flow.

Mr. Hicks then reported an allocation of \$551,377 from the Contingency Account to fund a series of moves by state agencies from privately-owned leased space to state-owned space. The following agencies have relocated to state-owned space: the Department of Revenue (Owensboro) has relocated to the Owensboro State Office Building at a cost of \$71,109; the Department of Workers' Claims has relocated to the Council of State Governments Building in Lexington at a cost of \$59,729; and eight Boards have relocated to Spindletop in Lexington at a cost of \$420,539.

Mr. Hicks said the 2005 General Assembly passed House Bill 241 which provides for the transfer of funds from the Contingency Account for non-recurring moving expenses of state agencies. At the end of 2006 when these moves were completed, the Secretary of Finance approved the first-time ever allocation from this account for these

expenses. The moves were carefully thought out and assisted the Commonwealth in decreasing the amount of leased space by 25,000 square feet. He explained that his office inadvertently forgot to report the Contingency Account allocation prior to its transfer as required by statute. He apologized for that action. Mr. Abbott said he too shared in the fault of not reporting the action. Committee Action is normally required to approve transfers from the Contingency Account; however, the transfer had already been made and no action was taken.

Mr. Hicks next reported a modification in the allocation of the \$35 million Parks Renovation Pool. Mr. Hicks said that \$900,000 from this pool will be allocated to begin design work on the new outdoor stadium project for the Kentucky Horse Park. [On March 29, 2007 Governor Fletcher authorized the Commerce Cabinet to utilize funds from the Parks Renovation Pool to begin the design phase for a new outdoor stadium in preparation for the 2010 Alltech FEI World Equestrian Games.]

Mr. Hicks said in order to "free up" funds for this project two other projects will be modified, the Levi Jackson State Park campground upgrades (\$800,000) may be funded from the 2006-08 Parks Development Pool and the Central Office Various Park Utility Improvements project will be reduced from \$500,000 to \$400,000. No further Committee action was required for this project.

The last item Mr. Hicks discussed was a scope increase of \$22,512 for the Department of Military Affairs (DMA) Emergency Operations Center HVAC Upgrade project. In August 2006, this project was reported at a scope of \$657,000 funded by DMA's Deferred Maintenance Pool project authorized in the 2004-06 budget for \$2,300,000 in state bond funds. The scope increase is needed to address design revisions to ensure adequate airflow. The funding sources for this scope increase are 50% from federal funds (\$11,256) and 50% from the Finance Cabinet's 2004-06 maintenance pool (\$11,256).

Nancy Brownlee, Director, Division of Real Properties, discussed a lease modification report for the Department of Public Advocacy (PR-4681) in Boone County. She said Public Advocacy plans to create additional office space within its existing leased facility to accommodate three new staff attorneys and a staff support employee. The cost of the modifications, \$13,860 plus 8.25% interest, will be amortized through the current lease expiration date of June 30, 2010. No action was required by the Committee for this project.

Senator Tori next welcomed Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority (KIA). Ms. Williams presented various coal/tobacco development grants that were funded through line item appropriations from the General Assembly in 2003, 2005, and 2006. Also included was one community development

grant funded with an appropriation from the 2006 General Assembly. No action was required from the Committee.

Representative Damron asked if the proceeds of the old bond pools had been spent so as to not be left with arbitrage costs. Ms. Williams said KIA would present an arbitrage report on the 2001 issuance for the 2020 program bonds to the Committee at its May meeting. She said they will not owe any arbitrage rebate.

Representative Damron said language was written into the 2008 budget to provide authorization for the projects that were approved in future bond budgets to be able to use dollars in previously authorized bond pools. He said the legislature and LRC staff raised concerns about arbitrage issues associated with these previous bond pools. No action was required from the Committee.

The next report was provided by Tom Howard, Executive Director, Office of Financial Management (OFM), and Terri Fugate, Deputy Executive Director, OFM. The first item Mr. Howard presented was a new bond issue report: Kentucky Asset / Liability Commission (ALCo) Floating Rate Notes, 2007 General Fund Series. Proceeds from this issue will provide \$100 million in permanent financing for two projects authorized in the 2006-08 budget: the Louisville Arena project (\$75 million) and the Petroleum Storage Tank Environmental Assurance Fund (\$25 million). The issue will also advance refund portions of the State Property and Buildings Commission Projects 79 and 85. As part of the advance refunding, the tax status of the bonds will be maintained as it will be within the ten and one-half year period specified in the tax code for "safe harbor," in case there is a change in use in any of the facilities associated with the issue.

The issue will be a negotiated and insured transaction that is expected to sell on May 15, with an all-in true interest cost is 4.18% and callable at par in ten years consistent with the "safe harbor" provisions. The estimated present value (PV) savings is approximately \$3.7 million or 2.70% of refunded par.

Mr. Howard said the debt will be structured as floating rate notes, a first for the Commonwealth. With floating rate notes, the interest owed on the debt will be 67% of the 3-Month London Inter-Bank Offered Rate (LIBOR) plus a spread. ALCo plans to enter into a fixed payer interest rate swap agreement as a hedge, whereby ALCo will receive 67% of LIBOR plus a spread from its counterparty and pay to the counterparty a fixed rate.

Mr. Howard said the floating rate note product is relatively new in the municipal market, but has been in the taxable market for a long period of time. This product has developed as overseas investors assume tax risks in their investments. The overseas investors believe that the tax rates in the United States will not go down. Therefore, the market for this product could be more diversified.

When analyzing the refunding aspect, OFM compared it to other structures such as variable rate debt or fixed rate non-callable debt. Variable rate debt typically has multiple fees associated with it - such as remarketing, liquidity, and on-going maintenance fees - that the floating rate note structure does not have. Fixed-rate non-callable structures have features that would not generate the same level of economic benefits.

Mr. Howard noted it was not the first time the state has used interest rate swaps to refund debt. This approach was used for the Turnpike Authority's debt related to Resource Recovery bonds and Toll Road bonds. He said the Toll Road bonds were paid off in late December 2006 and netted an additional \$1.8 million in savings that would not have otherwise been generated through a traditional product.

Representative Damron asked if the swap would ever be terminated. Mr. Howard said not in this case, the swap would be insured just like the notes so the payments would be guaranteed. He said OFM monitors swap agreements on a regular basis.

Representative Denham made a motion to approve the ALCo bond issue. The motion was seconded by Representative Rudy and passed by unanimous roll call vote.

Mr. Howard presented the second new bond issue: Kentucky Economic Development Finance Authority (KEDFA) Revenue Bonds, Series 2007 (Adventist Long-Term Care Obligated Group). The proceeds from this issue, \$8,840,000, will refund exiting obligations that are outstanding for four facilities: Princeton Health Care Manor, Russellville Health Care Manor, Leitchfield Health Care Manor, and Mills Manor Nursing Home in Mayfield.

Senator Rhoads made a motion to approve the new bond issue for KEDFA. The motion was seconded by Representative Denham and passed by unanimous roll call vote.

Ms. Fugate presented a follow-up report for a previously approved bond issue: University of Louisville General Receipts Bonds, 2007 Series A, in the amount of \$41,040,000. She said proceeds from this issue will pay for financing six different projects. This was the University's first issue under a new General Receipts Trust indenture. No action is required for follow-up reports.

Ms. Fugate then reported four new school bond issues with School Facilities Construction Commission (SFCC) debt service participation for Hardin County, Henry County, Knox County, and Leslie County.

Representative Rudy made a motion to approve the SFCC bond issues. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote. Representative Damron abstained from the vote, citing a potential conflict of interest.

Ms. Osborne said there were three locally-funded school district bond issues submitted to the Committee for review this month for Hardin County, Henry County, and Oldham County. She said all disclosure information has been filed and no further action on the bond issues is required.

With there being no further business, the meeting adjourned at 2:40 p.m.