STATE OF ARIZONA

Joint Committee on Capital Review

STATE SENATE

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HOUSE OF REPRESENTATIVES

MINUTES OF THE MEETING
JOINT COMMITTEE ON CAPITAL REVIEW

Thursday, September 21, 2006

The Chairman called the meeting to order at 1:45 p.m., Thursday, September 21, 2006 in House Hearing Room 4 and attendance was as follows:

Members:	Senator Burns, Vice-Chairman	Representative Boone, Chairman
	Senator L. Aguirre	Representative Brown
	Senator Cannell	Representative Lopes
		Representative Pearce
		Representative Tully
Absent:	Senator Aboud	Representative A. Aguirre
	Senator Bee	Representative Biggs
	Senator Gould	
	Senator Johnson	

Hearing no objections from the members of the Committee, Representative Boone stated the minutes of August 24, 2006 would stand approved.

DIRECTOR'S REPORT

Mr. Richard Stavneak, Director, JLBC Staff, asked the Committee members to try to attend the October 24, 2006 Committee meeting to avoid difficulties in getting a quorum.

ARIZONA DEPARTMENT OF TRANSPORTATION – Review of FY 2007 Construction Budget Operating Expenditure Plan.

Mr. Bob Hull, JLBC Staff, presented the review of the Arizona Department of Transportation's (ADOT) FY 2007 Construction Budget Expenditure Plan. The Committee has heard this item twice before. At its July meeting, the Committee approved $34.6 million through the end of October and requested additional information on the Auditor General report. ADOT requests $103.6 million for the Construction Budget Professional and Outside Services. The JLBC recommendation memo from the July meeting still applies for this item. An additional handout was provided to summarize the Auditor General's recommendations *(Attachment 1)*.

Representative Tom Boone asked if the original JLBC Staff recommendation was a favorable review.

Mr. Hull said the original recommendation was a favorable review since it is in line with previous year's expenditures.

Representative Boone stated the Committee needed to consider 2 other possible options: have the department report more information at the next meeting or wait for the sunset review process.

Representative Boone asked if the Auditor General findings would be covered during the sunset review process. Mr. Hull said yes.

Representative Phil Lopes asked when the Committee of Reference would meet. Mr. Hull said that the Committee would meet in fall 2007.

Representative Lopes asked for clarification on the JLBC Staff recommendation. Mr. Hull replied that the JLBC Staff recommends that the Committee give a favorable review. The Committee could request additional information, as noted in the handout, if it chose to pursue the consultant issue.

Senator Burns said he understands that ADOT agreed to the Auditor General findings regarding the use of consultants. He asked if there was a plan in place for a reduction in consultant use in the upcoming year.

Mr. Terry Trost, Budget Director, ADOT, said the consultants have contributed to their success on state highways and roadways. One of the issues is the mix of in-house staff and consultants being used by the department. There is a budget issue submitted for FY 2008 that scratches the surface on one of many strategies the agency could employ with consultants. The agency believes in-house staff better serves positions in roadway right-of-way and bridge and environmental planning areas. There are other strategies being looked at.

Senator Burns asked for the cost estimate for reduced consultants and an increase of in-house staff.

Mr. Trost said they are looking at 22 positions and approximately $4 to $5 million. The use of consultants is significant when looking at program and project requirements.

Senator Burns said that according to 1 of the Auditor General recommendations, ADOT needs to improve documentation of inspections and auditing of the contracts. He asked how ADOT plans to measure the improvements.

Mr. Brian McInnis, Chief Auditor, ADOT, said there were 6 recommendations relative to ADOT's Office of Audit Analysis. The basic recommendations included staffing levels, the audit management system, revisions to the audit manual, and an annual risk-based audit plan. Five of the 6 recommendations have been fully implemented. The department staffing is currently at an 85% staffing level. The new audit management system, which allows the department to do performance measurements on the effectiveness of the audits, was fully implemented in September. The outdated audit manual was updated and completed July 31. The annual audit plan for FY 2007 was completed on August 14.

Representative Pearce said the outside professional consultants have increased by 425%. This type of an increase can be a concern especially when there are in-house staff that can do the same job that the outside consultants have been hired to do. There are also concerns with the incomplete inspections and check lists not done in some cases. Field inspectors say 66% of the work met inspection and the independent inspectors found 35% of the work met inspection. There is also the time it took for the extension of the Maricopa County highway dollars, 45% of those dollars were taken away for other projects. There is a serious issue with our freeway construction trying to meet demands for the state. He would like to see reduction of the consultants or a better support of the reason why money is being used for the consultants.

Mr. Terry Trost said he understands the concerns and the agency would like to bring more people in-house but it would only be on an appropriate basis if it belongs within a state agency. They will be coming forward with more recommendations as they look into the issue of how to replace and supplant.

Representative Pearce said that the design-build procurement method was meant to minimize the need for consultants and have an in-house workload reduction.

Mr. Trost said that it is a more effective and efficient process. However, it does not come without a cost.

Representative Lopes said that 425% increase is over a 10-year period, or about 40% per year. He asked what an acceptable increase is, if the 425% increase is not acceptable.

Mr. Trost said that he does not know if there is a national standard. The 425% is a shocking number, but it was also over a period when they agency was pushed to accelerate the freeway system and deliver more miles in less time. One of the mechanisms used to deliver that was the use of private consultants.

Ms. Shan Hays, Performance Audit Manager, Office of the Auditor General, said the use of consultants is widespread amongst state's transportation department, the range of the use in some states have been in 5% to 95% of projects. There is no defined number. They compared ADOT's use of consultants with use in other states and they appeared to be among the highest in the use of consultants.

Representative Lopes asked if the use seems high relative to other state agencies or relative to other states.

Ms. Hays replied that the result was in both. A couple of years ago, the Governor's efficiency review found that ADOT had a higher use of consultants compared to all other agencies combined. They understand that ADOT uses the consultants differently that other state agencies, so they also looked at how other state agencies use their consultants. There is a wide range of consultant usage but Arizona and ADOT seem to be among the highest in the use. The comparison of growth in the workload was considered since they had an accelerated workload and more complexity in the workload which requires them to use the consultants with special expertise. The bottom line was that it is ADOT's responsibility to determine what the right level is and use good practices to determine when to use a consultant.

Representative Boone said the recommendation from JLBC Staff is to give a favorable review. He asked members to what extent the Professional and Outside Services should be continued or if members want to wait until the budget process begins.

Representative Pearce said he has concerns with the growth in outside consultants. He agrees with the Auditor General in that the use seems high. He prefers to leave this for the appropriations process.

Mr. Stavneak said that Committee questions can be conveyed to ADOT then decide whether the Committee would like to look at this more extensively in the appropriations process.

Representative Lopes agreed with Mr. Stavneak and to take any action before the budget process would be premature.

Senator Burns moved the Committee give a favorable review of ADOT's $103,644,800 Professional and Outside Services expenditure plan for FY 2007. The Committee is also interested in getting more ADOT input on the Auditor's finding and requests that the department report to the Committee by October 20, 2006 on the following items:

1. *ADOT's current and proposed dollar amount for engineering pay plan salaries, and how it might affect vacancies.*
2. *ADOT's target for reduced consultant use.*
3. *ADOT's targets for meeting the Auditor General's second and third recommendations concerning improved documentation of inspections and auditing of its contracts.*

The motion carried.

ARIZONA DEPARTMENT OF TRANSPORTATION – Report on 5-Year Transportation Plan.

Mr. Bob Hull, JLBC Staff, presented the 5-year report on ADOT's Transportation Plan. Since the Legislature neither appropriates all 5-year plan funding nor approves individual projects, the Committee traditionally requests information on the plan to ensure some legislative oversight. To improve Legislative oversight over the years, the Committee has requested an executive summary, congestion performance measures, and maps of congested highway segments. After reviewing the plan, JLBC Staff believes that further improvements would be useful. He referred to a handout and explained the executive summary *(Attachment 2)*.

Senator Robert Cannell asked if the cost was based on inflation.

Mr. Hull replied that ADOT has revenue flow projections for which they take out inflation. In the 5-year plan, they discount to current year dollars. They take into account expected increases in the revenue when they allocate for projects.

Senator Cannell asked if inflation is considered in the costs to the material.

Mr. Hull said that the project costs are discounted into the current year, so the cost in the 5-year plan would be higher.

Senator Burns said ADOT is limited by statute for HURF revenues to be more than 3 times the debt payments and current revenues are 4.8 times more than the debt requirement. He asked if ADOT has a long-term goal for the revenue to debt ratio

Mr. John McGee, Chief Financial Officer, ADOT, said for the current project plan there is approximately $800 million in HURF bonds that will be issued. That is what was needed to balance the program. The financial advisor did an estimate on the bond plan and the low point at 4.3 coverage on HURF bonds. Debt service is not the only thing paid with the HURF revenues. There will be $650 to $700 million in HURF revenues. The highest maximum debt service during the period will be $100 to $150 million. The operating program is also funded from HURF, of which the state highway portion is $300 to $350 million.

Senator Burns said the Maricopa Regional Area Road Fund bond issuances will increase over the next few years. He asked how much that will increase the debt service payments.

Mr. McGee replied that the half-cent sales tax in Maricopa County is a limited term tax. The bonding has to be repaid within the 20-year term. Unlike HURF, the only 2 uses are for construction and debt service. The program anticipates an aggressive bonding strategy. The plan is to bond to a coverage ratio of 1.2 of revenue. It significantly accelerates the work in the bond program. They are able to bond it down to a lower level and make it a competitive project because there are no other demands on the revenue.

Senator Burns asked how the need is measured and if there is some type of ranking system in picking projects.

Mr. McGee replied that it differs with respect to statewide programs or Maricopa County programs. Under statute, the prioritization of projects within Maricopa County falls within the Maricopa Association of Governments (MAG). The plan is put together project-by-project and quarter-by-quarter for the entire 20-year of the half-cent sales tax. It is subject to change if issues are encountered. Pima County follows a similar course with the Pima Association of Governments and Tucson gives recommendations.

Representative Boone said this plan does not have action that needs to be taken, however, there are recommendations to ADOT's 5-year plan for next year.

Senator Burns moved that the Committee adopt the recommendation submitted by JLBC Staff that ADOT provide an Executive Summary of its 5-Year Transportation Facilities Construction Program for FY 2008-FY 2012, due by July 31, 2007. The Executive Summary should include the information in Tables 1-9 of the memo, plus:

- *A narrative explanation of the changes in revenues and expenditures between the FY 2007-FY 2011 and FY 2008-FY 2012 plans.*
- *A narrative description of major projects added and removed since the FY 2007-2011 plan, along with the current status and completion dates for removed projects.*

- *Separate the listing of 3 revenue dollar amounts for bonds, notes, and HELP loans. In addition, debt service payments should be listed separately and not deducted from revenue.*
- *A table that crosswalks next year's obligation basis 5-year highway program revenues to ADOT's cash flow projections, along with an explanation of the reasons for differences.*
- *A comparison of ADOT's bonding level to the statutory HURF Bond coverage requirement and the bond agencies' rating standard.*

The motion carried.

UNIVERSITY OF ARIZONA – Review of Residence Life Building Renewal Phases III and IV Bond Projects.

Ms. Leah Ruggieri, JLBC Staff, presented the University of Arizona (UA) request of $21.9 million for Phases III and IV of Residence Life Building Renewal projects. The Residence Life Building Renewal Projects occurred in 5 phases. The Committee previously favorably reviewed Phases I, II, IIA. Phases III and IV will be replacement of fire sprinkler and plumbing systems inside residence halls. UA will issue system revenue bonds for a term of 25 years with an annual debt service of $1.9 million. They pay the debt service with housing fees. The costs per square foot are outlined in Tables 1 and 2 in the JLBC recommendation memo. UA plans to contract the projects using the Construction Manager at Risk method.

Senator Burns said the interest rate for these projects is higher. He asked why dorm fees are considered a less stable revenue source.

Mr. Joel Valdez, Senior Vice President-Business Affairs, University of Arizona, said that the interest rate is determined by the market in which the bonds are sold. The fees that are charged to residents in the halls cover all the costs. The interest rates cannot be anticipated to what the interest rates will be at the time of the issuance. The rates charged to the residents are established by the Board of Regents. This is a multi-year multi-phase project approved by the Regents and the capital committee. These projects need to be done in the summer when there are no residents.

Mr. Kurt Freund, Managing Director, RBC Capital Markets, said the universities issue different types of debt. This particular type of debt is the system revenue bond issue which is secured by system revenues of UA. The system revenues consist of tuition fees, university fees, and auxiliary revenues. These bonds are tied to student dormitory fees. They will be paid by the university out of that source. The interest rate on the bonds will not be higher because the security for the bonds is the total revenues of the university. The interest rate will be in the low 4% range under today's market.

Senator Burns asked if there is a breakdown of the increased cost of construction due to inflation and how much is due to the requirements of the building.

Mr. Valdez said costs and timing are important issues. The costs will continue to escalate the longer it takes to do renovations.

Representative Boone asked if there is an outside 3rd party being used on the project.

Mr. Valdez replied that the outside party was selected by the university to work in conjunction with the contractor on this project.

Representative Boone requested a breakdown of the projects that includes contingency amounts and architect fees.

Senator Burns moved the Committee give a favorable review, as recommended by JLBC Staff, to the request of $21.9 million Residence Life Building Renewal Phases III and IV Bond Projects with the following standard university financing provisions:

- *UA shall report to the Committee before expenditure of any allocations that exceed the greater of $100,000 or 10% of the reported contingency amount total for add-alternates that do not expand the scope of the project. UA shall also report to the Committee before any reallocation exceeding $100,000 among the individual planned renovations, renewals, or extensions.*
- *UA shall submit for Committee review any allocations that exceed the greater of $100,000 or 10% of the reported contingency amount total for add-alternates that expand the scope of the project. In case of an emergency, UA may immediately report on the scope and estimated cost of the emergency rather than submit the item for review. JLBC Staff will inform the university if they do not concur with the emergency nature of the change in scope.*
- *A favorable review by the Committee does not constitute endorsement of General Fund appropriations to offset any auxiliary revenues that may be required for debt service, or any operations and maintenance costs when the project is complete. Auxiliary funds derive from substantially self-supporting university activities, including student housing.*

The motion carried.

ARIZONA STATE UNIVERSITY – Review of Polytechnic Academic Complex Lease-Purchase Project.

Ms. Leah Ruggieri, JLBC Staff, presented the Arizona State University (ASU) request to issue a lease-purchase of $103 million to construct a Polytechnic Academic Complex that will be located at the ASU East Campus. The Polytechnic Academic Complex would be approximately 240,000 square feet with 3 new buildings comprised of office, classroom, and lab space. To finance the project, ASU would issue Certificates of Participation (COP) for a term of 30 years with an annual debt service of approximately $7.5 million. The annual debt service would be funded by the discretionary adjustment that the university received in the FY 2007 budget. *Table 1* of the JLBC recommendation memo lists other projects that have office and classroom space similar to the Polytechnic Academic Complex. The complex falls on the higher end of per square foot costs, however, there are 2 factors to consider. The first is the projects listed do not involve lab space and the second is inflationary increases have occurred in the process since the construction of buildings. The project will be contracted using the Construction Manager at Risk (CMAR) method.

Representative Boone said the $103 million is the COP issuance for the project construction. He asked if the total cost with the 30 year debt service amount would be approximately $224 million. Ms. Ruggieri said yes.

Senator Burns asked how renovations for the vacated spaces will be funded in the future.

Mr. Scott Smith, Director of State Relations, ASU, replied that the space will be backfilled, however, the plans are still under development. They will be submitted as soon as they are complete.

Representative Boone referred to the Capital Project Budget Summary in the Executive Summary. He asked why the Architect/Engineer Fees seem higher than the current market and if the Project Management Cost are for an outside firm.

Mr. Smith replied that there is an in-house position that manages the projects. He will follow up with more information.

Senator Burns moved the Committee give a favorable review, as recommended by the JLBC Staff, to the $103 million Polytechnic Academic Complex lease-purchase project with the following standard university financing provisions:

- *ASU shall report to the Committee before expenditure of any allocations that exceed the greater of $100,000 or 10% of the reported contingency amount total for add-alternates that do not expand the scope of the project.*
- *ASU shall submit for Committee review any allocations that exceed the greater of $100,000 or 10% of the reported contingency amount total for add-alternates that expand the scope of the project. In case of an emergency, ASU may immediately report on the scope and estimated cost of the emergency rather than submit the item for review. The JLBC Staff will inform the university if they do not agree with the change of scope as an emergency.*
- *A favorable review by the Committee does not constitute endorsement of General Fund appropriations to offset any auxiliary revenues that may be required for debt service, or any operations and maintenance costs when the project is complete. Auxiliary funds derive from substantially self-supporting university activities, including student housing.*

The motion carried.

ARIZONA EXPOSITION & STATE FAIR BOARD – Review of FY 2007 Building Renewal Allocation Plan.

Mr. Tyler Palmer, JLBC Staff, presented the review of the State Fair Building Renewal Allocation. The plan as presented is for $430, 600 consisting of 5 projects, 4 of which include paving and the other for a temporary roof repair. This would leave $1 million for a future Committee review.

There was no discussion on this item.

Senator Burns moved the Committee give a favorable review, as recommended by JLBC Staff, to the FY 2007 Building Renewal Plan of $430,600 for the 5 submitted paving and roof projects with the provision that AESF submit for Committee review an allocation plan for the remaining $1,077,800 if monies are to be used for additional projects. The motion carried.

Without objection the Committee meeting adjourned at 3:03 p.m.

Respectfully submitted:

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Yvette Medina, Secretary

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Lorenzo Martinez, Assistant Director

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Representative Tom Boone, Chairman

NOTE: A full tape recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams.

Attachment 1

ADOT's CONSTRUCTION OPERATING BUDGET

September 21, 2006
JLBC Staff

Auditor General Findings

- Optimize internal resources to reduce consultant usage.
  - Auditor General notes that consultant payments increased 424% in the past decade.
  - ADOT agrees, but would need to increase pay to keep staff.
  - ADOT does not specify the cost of pay parity, or whether it can be done.

- Improve and better document inspections.
  - 43 of 47 inspectors' diaries were incomplete.
  - 27 of 47 inspectors did not fill out required checklists.
  - Field inspectors found 66% of work met specs, but independent inspectors found that only 35% met specs.

- Improve contract audits.
  - Audits were backlogged, and 7 of 16 positions were vacant.
  - Staffing has improved to 92%, with 2 vacancies.

Recommendations

- A favorable or unfavorable review of ADOT’s $103.6 million Professional and Outside Services expenditure plan for FY 2007.
- If interested, ask for more information on the Auditor’s findings, as as shown at the bottom of page 1 of the memo.
- Or, defer the issue to the sunset review process’ Committee of Reference.

Attachment 2

EXECUTIVE SUMMARY

ADOT'S 5-YEAR TRANSPORTATION PLAN FY 2007 - FY 2011

September 21, 2006
JLBC Staff

ADOT's 5-Year Plan
FY 2007 - FY 2011
$ in billions

	06 - 10	07 - 11
• Highways	$5.1	$5.8
• Aviation	0.7	0.7
	$5.8	$6.5

Revenues - Highway Program

FY 2007 - FY 2011

$ in billions

	06 - 10	07 - 11
• State Highway Fund	$1.0	$0.8
• Regional Area Road Fund	0.6	0.4
• Federal Funds	1.9	2.2
• Bonds, Notes, & HELP Loans	1.6	2.4
	$5.1	$5.8

- Revenues are shown in current fiscal year dollars, and therefore do not show the actual funds collected over the 5 years.
- Debt service payments are deducted from revenue and are not displayed as expenditures.

Expenditures - Highway Program

FY 2007 - FY 2011

$ in billions

	06 - 10	07 - 11
• Preservation	$0.8	$0.9
• Improvements	1.2	1.3
• Management	0.4	0.4
• Total Statewide Program	$2.3	$2.6
• MAG Freeway System	2.8	3.2
	$5.1	$5.8

- Expenditures are shown on an obligation basis, and do not represent cash flow.
- Expenditures exclude debt service, which is netted out of revenue.
- The $5.8 billion does not include the $307 million from the FY 2007 budget to accelerate certain highway projects.

Major Projects Over $25 Million

- $3.1 billion will be spent on 33 major projects above $25 million.

11 New Major Projects in FY 2007 - 2011

$ in millions

North Valley	07 - 11
I-17 – Jomax/Dixileta Interchanges	$40
L303 (Estrella) – Happy Valley Rd to I-17, interchange	30
West Valley	
I-10 – Sarival Rd to Dysart Rd, widen & HOV	90
I-10 – Dysart Rd to L101 (Agua Fria), widen & HOV	54
East Valley	
I-10 – SR 51 to 40th St, collector distributor road	140
L101 (Pima) – Tatum Blvd to Princess Dr, HOV	28
Tucson	
Tucson I-10 – Ina Rd, interchange	38
Tucson I-19 – Valencia Rd to Ajo Way, widen	38
Balance of State	
Safford US 191 – MP 151 to Threeway, widen	33
Kingman US 93 – Hoover Dam to MP 17, widen	80
Prescott SR 260 – Little Green Valley, widen	27

Bonding - Highway Program

FY 2007 - FY 2011

Outstanding Obligations	FY 2007	FY 2011
• HURF Bonds	$1.5 Billion	$1.8 Billion
• MRARF Bonds	386 Million	1.3 Billion
• Grant Anticipation Notes	283 Million	315 Million
• Board Funding Obligations	200 Million	200 Million
• HELP Loans	121 Million	0

- The $1.3 billion HURF bond statutory limit was removed in FY 2007.
- MRARF bonds reflect large bond issues and small repayments in the early years of the second 20-year Maricopa freeway program.
- HELP loans decrease to $0, since ADOT does not try to project which future projects might be accelerated by using HELP loans.

Bonding - Highway Program
FY 2007 - FY 2011

- By statute, annual HURF revenues must be at least 3 times the highest annual debt service payments for HURF bond issues.
- The current HURF bond debt service ratio is 4.5. This ratio is the key factor in determining bond ratings.
- ADOT's HURF bonds, MRARF bonds and GANS are rated high quality by the bond rating services.
- S&P gives HURF bonds their highest "AAA" rating.
- S&P gives MRARF bonds and GANS their second highest "AA" rating.
- Moody's gives HURF bonds, MRARF bonds and GANS their second highest "Aa" rating.

Over Capacity Highway Segments

- As an on-going performance measure, we have attempted to track how the 5-Year Plan addresses most congested segments

Over Capacity Definition

• Phoenix & Tucson Areas	• Traffic volume exceeds capacity from 6 to 9 AM or 3:30 to 6:30 PM
• Rest of State	• Traffic volume exceeds capacity

Over Capacity Highway Segments

- There are 20 overcapacity highway segments, including 13 in the Phoenix area, 4 in the Tucson area, and 3 in the rest of the state.
- The plan addresses all 20 “over capacity” highway segments, which are shown in *Tables 5 - 7*, along with planned actions.
- Attachments B - D are maps of the congested segments, the planned projects, and Phoenix area AM and PM congestion in 1-hour intervals.

Revenues - Aviation Program

FY 2007 - FY 2011

$ in millions

• Federal Grants	$589
• State Aviation Fund	96
• Local Governments	32
	$717

Recommendations

- ADOT provide an Executive Summary for its 5-Year Transportation Program for FY 2008-2012, due by July 31, 2007. The Executive Summary should include the information in *Tables 1-9*, plus:

  - A narrative explanation of the changes in revenues and expenditures from this year's plan.
  - A narrative description of major projects added and removed since this year's plan, along with the status and completion dates for removed projects.
  - A table that crosswalks next year's obligation basis 5-year highway program revenues to ADOT's cash flow projections, along with an explanation of the reasons for differences.
  - A comparison of ADOT's bonding level to the statutory HURF Bond coverage requirement and the bond agencies' rating standard.