

The Higher Education Bonds: Hindsight and Foresight

A moratorium on bond sales is allowed by the legislation authorizing them. A moratorium would give the state significant savings right as it faces an unprecedented budget deficit. It would also lessen the state's need to lay off current employees.

By George C. Leef

Summary: The campaign for the higher education bonds in 2000 told North Carolina voters that the bonds were the best way to handle the University of North Carolina system's deteriorating facilities and its pressing needs for new buildings to accommodate an expected surge in enrollment. Bond supporters were adamant and explicit in promising voters that the bonds wouldn't raise their taxes. Now two years after passage, taxes have already risen and the deepening state budget crisis threatens to see them increase again, UNC is favoring new construction over supposedly critical repairs, there has been no sign of a massive surge in enrollment, and UNC is unnecessarily and openly pursuing contracting procedures that are possibly illegal and likely more costly. A moratorium on the bond sales, allowed by the legislation approving the bonds, appears to be the most responsible way to navigate the state's fiscal crisis and UNC's crisis of credibility with N.C. voters.

In the November 2000 general election, North Carolina voters had to decide on a massive bond proposal that would devote \$2.5 billion to the University of North Carolina system and \$600 million to the North Carolina Community College System. Well-organized supporters spent several million dollars in promoting the bond proposal, informing the voters that the funds were necessary in order to repair buildings that had been allowed to fall into serious disrepair and to expand the system to accommodate more students. The campaign took great pains to assure voters that passage of the bond proposal would not lead to a tax increase. Voters responded favorably, passing the measure easily with more than 70 percent in favor.

Since that time, the 16 UNC campuses have made considerable progress on the numerous bond projects, although that

progress is very uneven among the campuses. Meanwhile, the fiscal situation facing the state has changed dramatically, with large budget deficits in 2001 and 2002 leading to reassessment of the state's spending priorities.

This paper will take a look back at what has transpired with the bonds and the projects they fund and also to the future, inquiring whether, given North Carolina's dire budgetary situation, a moratorium on future bond sales and commitments for construction work would be advisable.

Background

On April 9, 1999, the consulting firm Eva Klein & Associates presented to the UNC Board of Governors a report entitled "Building for the New Millennium." The report evaluated the condition of the buildings at the 16 UNC campuses and concluded that, on the whole, the buildings were in poor condition when the projected cost of doing all necessary repair and renovation work on them was compared to their replacement values. It also projected the capital needs of the system based on expected population growth and consequent increase in demand for places for students. In total, the Klein report placed the capital needs of the UNC system at \$6.9 billion — \$2.4 billion for repair and renovation and \$4.5 billion for increased capacity.

Governor Hunt and many leaders in the General Assembly immediately embraced the report as proof that dramatic action was needed in order to deal with what was now called a "crisis." Elected officials hurried to find ways of raising money to deal with the crisis without pausing to ask critical questions, such as:

Voter were repeatedly and explicitly told that passage of the bond proposal "Will Not Raise Your Taxes."

a) *How has it happened that so many buildings have been allowed to deteriorate to such an extent over so many years?*

b) *Can this building condition "crisis" be managed by a simple redirection of existing state resources?*

c) *Does the expected increase in college students in the state really necessitate physical expansion of the state's university system?*

By June 1999, the General Assembly was considering legislation that would have allowed the state to borrow \$3.0 billion (\$2.7 billion of which would have gone for UNC projects and \$300 million for the NCCCS projects); critically, the bonds in that proposal would not have required voter approval.

Opposition to the plan, centering chiefly on the fact that the state would be taking on a significant amount of debt without allowing the citizens to decide if they wanted to do so, caused its collapse in the summer of 1999. UNC leaders, however, never abandoned their desire for a massive capital injection via a bond issue. There is no evidence that they considered any other approaches. With their backing, new legislation authorizing a slightly larger bond issue (\$3.1 billion) with a different division of funds (\$2.5 billion for the UNC system and \$600 million for the community colleges) was introduced in the 2000 session of the General Assembly. This time, however, the lightning rod was removed: the bonds would be state general obligation bonds subject to voter approval. Also, a number of special interest projects such as a performing arts center on Roanoke Island were dropped from the list of those to receive funding. With little opportunity for critical comment (proponents of the bond package were given hours to make their case in the legislative hearings, while opponents were told to take only two minutes each), the General Assembly passed the bill.

An alliance of business interests and the state's higher education community waged an aggressive campaign on behalf of the bond proposal, spending several million dollars on television, radio, and print advertisements. Many of the ads explicitly stated that passage "Will Not Raise Your Taxes." UNC Public Television, which stood to gain from passage because it would receive funding for new equipment, repeatedly broadcast a one-sided documentary, "A Building Crisis," that made conditions throughout the UNC system look abysmal. With no organized opposition, the proposal's approval was a foregone conclusion.

Bond Sales

The legislation approving of the higher education bonds subject to a vote of the people, Session Law 2000-3, provides that the bonds are to be sold in six yearly increments.

<u>Fiscal year</u>	<u>UNC bonds</u>	<u>NCCCS bonds</u>
2000-2001	\$201.6 million	\$48.4 million
2001-2002	\$241.9 million	\$58.1 million
2002-2003	\$483.9 million	\$116.1 million
2003-2004	\$483.9 million	\$116.1 million
2004-2005	\$564.5 million	\$135.5 million
2005-2006	\$524.2 million	\$125.8 million

All of the bonds authorized for 2002 have been sold. The Treasurer's Office will begin sales of the 2003 bonds in March 2003.

The Status of the Construction and Renovation Projects

Action on the numerous construction and renovation projects at the sixteen UNC campuses began shortly after the approval of the bond issue.

The following table shows the degree of progress at each of the campuses as of March 1, 2002. Projects were regarded as "Under Construction" where the document "Status of UNC Bond Program" indicated that they were under construction or where land acquisitions were underway. Projects were classified as "Design Stage" where the document indicates either that the project is under design or that a designer has been selected or advertised for. All other projects, where no information was given about progress, were classified as "No Action." The calculations are based on the dollar figures given in Session Law 2000-3 for each individual project.

<u>Institution</u>	<u>Under Construction</u>	<u>Design Stage</u>	<u>No Action</u>
Appalachian State	16%	70%	14%
East Carolina	34	50	16
Elizabeth City State	0	56	44
Fayetteville State	0	72	28
N.C. A & T	44	22	34
N.C. Central	<1	81	18
N.C. School of the Arts	32	44	24
N.C. State	13	53	34
UNC-Asheville	24	74	2
UNC-Chapel Hill	14	62	24
UNC-Charlotte	16	84	0
UNC-Greensboro	37	31	32
UNC-Pembroke	0	45	55
UNC-Wilmington	1	72	27
Western Carolina	53	16	31
Winston-Salem State	34	48	18
UNC Affiliated Inst. (includes UNC Public TV)	85	15	0

As of March 1, 2002, the amount of the projects then under construction totaled \$502 million.

Are the most pressing needs being tackled first?

North Carolina voters were told the bond issue was the best means of dealing with the badly deteriorated condition of many buildings throughout the UNC system. They were also told that the state needed to expand the system to handle an expected surge in students — an oft-repeated prediction was that by 2008, the student body will have increased by 48,000.

The more compelling justification was the poor condition of buildings — no one wants students trying to learn science in

antiquated labs, living in dilapidated dormitories or experiencing any of the other bad conditions that were widely publicized during the campaign over the bonds. The supposed need to expand the UNC system was (and is) far less persuasive a justification because students have many educational alternatives to attending one of the UNC system campuses. If UNC did not grow to accommodate more students, those who were not able to gain admittance to a UNC campus would turn to the wide array of independent colleges and universities as well as the growing availability of on-line educational offerings by UNC and hundreds of other universities around the country.

So, as a general proposition, the highest priority for the work approved under the bond proposal should be repairs and renovation — improving the bad living and learning conditions that clearly exist at many campuses. Expansion should have a lower priority. But do the projects already under construction or at the design stage reflect those priorities?

Of the 298 individual projects listed in the bond legislation, 195 are for building renovations and replacements. In most instances, those are classrooms, laboratories, and dorms, although there are some non-academic projects among them, such as Memorial Hall at Chapel Hill. As of March 1, 2002, only 16 of those 195 projects were under construction (8%); 85.5 were at the design stage (44%) and 93.5 had not registered any action (48%). (In some instances, projects were indicated as being in different stages with one stage further along than another; in those cases, the projects were treated as half in each.)

Of the 103 projects that are for new construction (expansion, additions, land purchases, etc.), 25.5 were under construction (25%), 50 were at the design stage (49%) and 27.5 have not registered any action (27%).

As the above results suggest, the UNC leadership does not appear to favor the repair and renovation of decaying facilities as top priority. On the contrary, the new construction projects are moving forth more rapidly on the whole than are the renovation projects.

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For example, the terrible condition of the residence halls at Elizabeth City State University was featured in the documentary “A Building Crisis,” with a student complaining about rodents, spiders, and the lack of hot water. Yet none of the three residence halls slated for renovation has even reached the design phase. What is under design, however, is new construction for a student center and physical education facilities.

No progress is reported on the renovation of Stilwell laboratory or the renovation of the Forsyth classroom and computer lab at Western Carolina University. The laboratory conditions at Western Carolina moved a student to tears on camera in “A Building Crisis.” Yet the new fine arts and humanities building is under construction.

There has also been no progress reported on the renovation of Rosenau Hall laboratory (highlighted for its inadequacy in “Building for the New Millennium”) or on the Berryhill Hall laboratory or the New West classroom building at UNC-Chapel Hill. The new Carolina Living and Learning Center is under construction, however, and the renovation/expansion of Memorial Hall is under design.

At N.C. State, no action is reported on the renovation of the Withers and Gardner science laboratories (highlighted for their inadequacy in the N.C. State Bulletin, “Special Bond Edition” of Oct. 27, 2000), Meanwhile, a new horticultural classroom at Raulston Arboretum is under construction and infrastructure for the Centennial Campus is under design.

Ground has been broken for the expansion of the Highsmith Student Center at UNC-Asheville, which will include a cafe with outdoor seating, a food court, office space for the student newspaper and other amenities, but the renovation of Carmichael and Zageir Hall classroom buildings has gone no further than advertising for a designer.

Where is the Surge of Students?

During the campaign for the bond, proponents frequently maintained the UNC system sorely needed a rapid and substantial expansion to handle the coming tidal wave in applications. UNC, they said, will have to accommodate an additional 48,000 students by 2008 — which would represent a 30-percent increase in the current student body. But do trends in applications and enrollment support the crash-expansion justification?

Starting in the fall of 1997, freshman applications from in-state students for places at UNC schools rose from 51,804 to

58,217 by the fall of 2000, then declined to 57,989 in the fall of 2001 — an increase of 11.9 percent. On average, 73 percent of the applicants were accepted (the figure varying greatly among schools). Of those accepted, on average only 50 percent actually enrolled — evidence of the wide range of non-UNC alternatives that students not only have to choose among, but also frequently find preferable. Based on the recent past, therefore, we see that out of every 100 applicants, the UNC system gets only 37 students.

If the UNC student body were to grow from the 160,000 it now enrolls to 208,000 by 2008 (the 48,000 net student increase forecast), the system would have to see application increases far larger than it has been experiencing. Over an eight-year period, the system would have to see a net gain in students of 6,000 per year. Assuming that the above percentages remain roughly constant, the average annual gain of 6,000 students would require an average annual increase in applicants of *more than 16,200* (6,000/.37). But in the period 1997-2001, the largest increase in applications was only 3,500 (from 1998 to 1999) — and from 2000 to 2001, there was even a slight decrease in applications.

Perhaps the large surge in demand for places at UNC schools is just around the corner, but the statistics from the last five years give no evidence of it.

Legal Preferences in Contracting for the UNC Projects

In September 2001, the UNC Board of Governors approved a plan drafted by the Office of the President regarding the use of “Historically Underutilized Businesses” in the construction projects to be undertaken with the funding supplied by the higher education bonds. The plan’s goal is “expansion of participation by Historically Underutilized Businesses ... to ensure and promote equal and increased opportunities for all segments of the design and construction community to participate in University construction projects.” State law (General Statutes 143-128) currently establishes a 10% goal for participation by minority businesses, which means 10% of the dollar value of state contracts is expected to go to “minority” businesses. UNC’s plan “seeks to supplement and expand, where reasonable and practicable, the efforts of the State’s Department of Administration in recruiting and selecting minority contractors for University construction projects.”

Not once were North Carolina voters informed prior to the 2000 referendum that UNC would use passage to “supplement and expand” the state’s contracting preferences law.

The plan does not explain why the University regards itself as morally bound to “supplement and expand” the current state law. The statute does provide that subdivisions of state government have the freedom to set a higher “goal” or employ more forceful means of achieving it if they desire to, but UNC has not given any rationale for implementing its own minority preference plan. Was it the case, perhaps, that in the past the University of North Carolina was particularly bad in refusing to do business with firms owned by minority-group members or women? No such evidence is given, and in fact it seems likely that UNC would have been the most fair of all branches of state government prior to the official outlawing of segregation and overt discrimination. There weren’t many black- or women-owned contractors in the state in the 1960s and earlier, but those that did exist would have certainly fared no worse in attempting to deal with UNC than with other parts of state government. So why does UNC feel compelled to attempt to “exceed the State’s goal of 10% for HUB utilization?”

Despite the state budget crisis, the UNC system is insisting on contracting procedures for bond projects that are probably more expensive.

The UNC plan requires substantial activity and monitoring to verify that contractors are using “good faith” efforts to meet the 10% “goal.” Each campus’s “HUB Liaison Officer” is, *inter alia*, directed to:

- Promote the University’s HUB program internally and externally.
- Develop and outreach agenda to facilitate HUB utilization.
- Participate in training seminars for the purpose of informing potential bidders/proposers/vendors of HUB programs and business opportunities available.
- Assure that projects are reviewed to determine the possibility of subdividing the work among multiple contractors. Requests for bids may be subdivided to encourage HUB participation.
- Assist the design team in developing methods for structuring bids, proposals, specifications, and plans so as not to unreasonably prejudice or limit HUB participation.
- Ensure that HUB goals and “good Faith Effort” requirements are included in requests for bid/proposals and are discussed during pre-bid/proposal conferences.

- Attend proposal (designer, construction manager, etc.) interviews to discuss proposer's plans to meet HUB goals and proposer's utilization of HUBs.
- Review good faith documentation for completeness.
- Conduct debriefing sessions, when requested, on awarded contracts, to explain why bids/proposals by HUBs may have been unsuccessful.
- Maintain records sufficient for verification of steps taken and evaluate efforts to increase HUB participation.
- Monitor HUB utilization throughout the duration of construction.

The plan also requires contractors to undertake costly steps to show that they have made "good faith efforts" to reach or exceed the 10% HUB goal. They must, for example, advertise that they will be looking for subcontractors and vendors in "trade association publications and HUB focused media" and provide written notice by certified mail to a minimum of three HUB contractors for each portion of work that was subcontracted. Contractors that fail to reach their 10% goal will be required to document their "good faith efforts" with the threat that if their attempt at showing "good faith" does not succeed with the HUB committee, they may have their bids rejected. It is clear that contractors have strong incentives to avoid the difficulties that attend a failure to reach the HUB goal and can be expected to go to considerable lengths to avoid the cost of the regulatory scrutiny that failing to reach the 10% goal triggers.

The 10% HUB target is apt to lead to higher costs than would be the case if contracting and subcontracting decisions were made entirely on the basis of price and quality. Particularly at a time when the state budget is awash in red ink, for the UNC system to insist on contracting procedures that are likely more expensive for bond projects is irresponsible.

The very legality of UNC HUB plan — and the state's plan as well — is doubtful.

Making it even more ill-advised, the very legality of UNC HUB plan — and the state's plan as well — is doubtful. Similar "good faith to meet percentage goals" plans have been repeatedly stricken down in the courts as unconstitutional violations of the right to equal protection of the laws. For example, Charlotte's minority contractor law, which also required contractors to use "good faith efforts" to ensure that a certain percentage of the value of contracts went to favored contractors, was recently challenged in court. Charlotte did not even raise a defense for it, agreeing to summary judgment against its program and terminating it. Since 1989, not one race-based government program for public contracting has withstood court challenge anywhere in the United States.

Should We Place a Moratorium on Bond Sales and Projects?

A moratorium is possible. The language of Session Law 2000-3 makes it clear: "If less than the aggregate amount of bonds of notes authorized to be issued in a fiscal year is issued in that fiscal year, the balance for that fiscal year may be issued in any subsequent fiscal year" (Sec. 116D-43). The General Assembly foresaw the possibility that circumstances might arise under which the state would be better off if it slowed or stopped the higher education building program so as to have more resources at hand for other state purposes. The statute and the referendum authorize the sale of bonds, but they do not mandate that the state must offer them.

The unprecedented budget deficit facing North Carolina this year — approximately \$1 billion — compels the state to look at every means of reducing expenditures. Governor Easley has been considering across-the-board cuts that would lead to layoffs of thousands of state employees, including employees in the UNC system. In response to the idea of a 4 percent budget cut, officials at UNC-Chapel Hill prepared a study that estimated layoffs at that campus of 70 faculty members and 93 other employees.

A moratorium on bond sales would give the state a significant saving. According to the State Treasurer's office, the cost to the budget of the bonds authorized for 2003 is \$62 million in principal and interest in the current fiscal year and \$60.5 million the next. Not immediately issuing the 2004 bonds would save \$63 million in that year.

If North Carolina were to impose a moratorium on the bond sales and put those projects that are not yet under construction on pause, it would delay for a relatively short period of time — a year, two years or whatever the duration of the moratorium — the completion of some of the UNC and community college projects. The question to ask is whether that would be less damaging to citizens of North Carolina than alternative means of closing the budget gap. A moratorium would not mean job layoffs in itself, and by reducing the budget deficit would lessen the state's need to make layoffs of current employees. Most students would find the delay in renovation and new construction tolerable, but for those who did not, there are other educational alternatives available. On balance, a moratorium appears less undesirable than either additional tax increases or

across-the-board budget cuts. (That is not to argue against budget cuts, which are needed, but cuts should be targeted at unnecessary functions, things the state should not be doing at all, rather than at a percentage of all state functions, including ones that are necessary.)

Finally, it is worthwhile to remember that a key selling point of the bond proposal to the voters in 2000 was the promise “It won’t raise your taxes.” Its approval, however, led to new budgetary obligations that helped to drive the budget into deficit and pave the way for the tax increases enacted in 2001. That promise was irresponsible and deceptive. A moratorium will not get rid of those tax increases, but it would at least make further increases less likely.

A moratorium on bond sales would give the state a significant saving while delaying bond projects only for a relatively short period of time.

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