

# Maryland

## Department of General Services



**FY 2012**

### **Capital Budget Analysis Response**

Senate Budget and Taxation Committee  
Capital Budget Subcommittee – March 22, 2011

House Appropriations Committee  
Capital Budget Subcommittee – March 25, 2011

**Martin O'Malley, *Governor***  
**Anthony G. Brown, *Lt. Governor***  
**Alvin C. Collins, *Secretary***

# Department of General Services

## Fiscal Year 2012 Capital Budget Analysis

### **Capital Program Request (page 7):**

DE0201A BPW: Lowe House of Delegates Building Renovation (Anne Arundel County)

Bill text: Provide funds to design and construct alterations and renovations to the Lowe House of Delegates Office Building.

General Obligation Bonds \$7,050,000

Department of Legislative Services Recommendation: Approve

### **DGS Response:**

*Concur*

Issues and Updates

1. State Center Redevelopment :

Response to DLS Issues:

**Debt Affordability Implications – Operating vs. Capital Lease**

**Recommendation (page 19)**

DLS recommends that the Treasurer re-examine whether the State Center is a capital or operating lease once final lease terms are available.

**DGS Response:**

*The final lease terms for the occupancy leases at State Center have been determined and approved by the BPW on December 15, 2010. DGS and MDOT agree with the Treasurer's Office and DLS for re-examining the determination of whether the occupancy leases are capital or operating. The assumptions under which the Treasurer made her determination would be best evaluated when the leases are fully executed, at the time the Developer has closed on its financing and the construction of the building and space for which the occupancy leases address is completed.*

*The decision to categorize the leases as operating was not pre-mature but timely and accurate based on the terms of the occupancy leases for space in Phase I buildings. The State's auditor determined them to be operating leases based on the terms and assumptions at the time of his review. Those terms and assumptions were then approved by the BPW on December 15, 2010. He further recommended that the appropriate time to determine whether the leases would be operating or capital would be when the State actually enters into the lease to confirm whether the terms and assumptions used to make the determination remain consistent.*

**Net Effect on the General Fund Budget**

**Recommendation (page 19)**

It is recommended that annual reports should be submitted to the budget committees to document actual general fund savings in the budgets of DGS, the Department of Health and Mental Hygiene (DHMH), MDP, and any other agency where offsetting expense reductions are expected to be found.

**DGS Response:**

*DGS agrees with the recommendation to submit to the Budget Committees, annual reports to document the actual savings of general funds for State Center tenants and DGS. The Administration believes that the Public Private Partnership approach to this project was the most feasible to achieve the objectives set forth for the State Center TOD: 1. replacement of State office buildings with highly efficient and sustainable office space for State employees, 2. reconnecting nine neighborhoods with a dynamic mixed-use environment, 3. increasing rider-ship on the State's transit system; and 4. minimizing the impact to the State's general fund.*

*Recognizing that it was not possible to fund the redevelopment of State Center out of the capital budget by deferring other critical capital projects, the Administration decided to use State assets to leverage private investment and create many other public benefits. The net effect of the proposed first phase of the project on the State's General fund Operating Budget is derived from average annual ground rent of \$157, 600 over 20 years plus 7% participation in the developer's net cash flow and capital events.*

*In addition to the mitigating impact of the income from ground rent and participation income, DGS and MDOT estimate the following public benefits:*

- New City taxes over 20 years - \$50 million*
- Private investment - \$175 million*
- New on-site construction jobs – estimated at 200*
- New permanent on-site jobs – estimated at 156*
- Minority and Women's business sub-contracting - \$75 million*
- Minority Equity ownership – 50% commercial and 100% for-sale housing*
- New State average annual tax revenue - \$8 million*

**Recommendation (page 19)**

The Administration should report the terms and conditions of the PILOT, as well as the effect on State rent. Furthermore, the Administration should report on the amount and planned use of the TIF to be issued and applied to the Phase I development as it has been reported that only approximately \$15 million of TIF financing is to be applied to Phase I.

**DGS Response:**

*DGS agrees to report on the approved terms and conditions of the City's PILOT and effect on the State's rent.*

*PILOT - The 28 acres and five buildings that comprise State Center currently pay zero taxes to the State of Maryland or Baltimore City. This is due to the fact that public property is exempt from real estate taxes.*

*A Payment in Lieu of Taxes (PILOT) substitutes a negotiated payment in place of the annual real estate taxes that would be due on a property. In State Center's case, since zero taxes are being paid on the property currently, a PILOT will give a predictable*

*dollar amount of new costs to the State in paying City property taxes on their campus that will be included in the operating expense portion of the State's rent.*

*State Center has requested that the City approve a PILOT of \$2.50/SF. The operating expense portion of the State's rent is estimated at \$11/SF of which the PILOT would represent \$2.50.*

*The proposed PILOT for State Center would accomplish two goals:*

*1) Guarantee new tax revenue to the City of Baltimore on property from which it currently gets ZERO tax revenue; and*

*2) Locks in the taxes the State will pay for the duration of their leases.*

*TIF - Tax Increment Financing. TIF is a method to fund improvements to public infrastructure by using future gains in new tax revenue from a development. The gain in new tax revenue is the "Tax Increment". The tax increment in Phase I of State Center will be used to fund the following public improvements:*

*Streets*

*Sidewalks*

*Public landscaping*

*Public Utilities*

*There is an important fact to understand about TIFs: TIFs can only be used to fund public infrastructure improvements (such as the examples above). TIFs cannot be used to fund private improvements to private property or developments.*

*The current estimate of the public improvements for Phase I is \$15 million. When this estimate is confirmed, DGS will report the finalization of this aspect of the project.*

#### **Recommendation (page 19)**

The Administration should report the "all-in" rent cost to the budget committees as soon as it has been determined.

#### **DGS Response:**

*DGS will report on the "all-in" rent cost to the Budget Committees. The base rent of \$25.85/SF has been approved in the current occupancy leases by the BPW at the December 15, 2010 meeting. The operating expense portion is estimated at approximately \$11/SF and will be confirmed after the first year of the buildings' operation.*

5. Energy Performance Contracting

**EPC Financing**

**Recommendation (page 33)**

DLS recommends that (1) DGS brief the committees on anticipated energy and maintenance savings; (2) Section 12-301 of the State Finance and Procurement Article be amended to clearly delineate that maintenance savings should be excluded from the calculation for determining whether energy savings exceed the annual debt payment; and (3) all subsequent BPW agenda items distinguish actual energy savings from maintenance savings.

**DGS Response:**

1) Anticipated maintenance savings had been interpreted to be cost avoidance realized as a result of the energy efficiency work such as reduced on-going maintenance on old equipment, replaced with new ones under the new energy contract. SF&P 12-301(b)(2) states “The payments and the total contract amount due under an energy performance contract may not exceed the actual energy savings realized as a result of the contract’s performance.” 2) DGS concurs to amend Section 12-301 to exclude maintenance savings from the calculation; and 3) DGS concurs that all subsequent BPW agenda items will distinguish actual energy savings from maintenance savings.

**Audit Findings Raise Concern about Energy Savings and Monitoring Verification**

**Recommendation (page 37)**

DGS should comment on what efforts it has taken to address the audit findings. DLS recommends committee narrative requiring DGS to submit an annual report summarizing the status of self-audits performed by each ESCO, including whether energy savings guaranteed by each ESCO have materialized. To the extent that funding is available, DLS also recommends that DGS conduct regular, independent third-party energy audits of EPC projects. It should be noted that DGS’ operating budget analysis includes committee narrative that addresses the aforementioned recommendations.

**DGS Response:**

*DGS followed up with the Office of Legislative Audits to address all the audit findings and provided reference to Federal Energy guidelines and other specific clarifications. We concur with the recommendation to submit an annual report summarizing the status of self-audits performed by each ESCO, including whether energy savings guaranteed by each ESCO have materialized. In addition, DGS is in the process of hiring a Measurement & Verification consultant to assist in the review and verification of the annual projected and guaranteed savings.*

**Recommendation (page 37)**

DGS should comment on its current practice for ensuring that the State is insulated from default by ESCOs. DLS also recommends that (1) all bond sureties and letters of credit be reviewed by the State Treasurer's Office prior to presentation to BPW; (2) all BPW items clearly delineate whether the surety agreement has been reviewed by the State Treasurer's Office prior to submission to the Board; and (3) DGS submit an annual status report that includes the dollar value and the anticipated expiration and renewal dates of all surety instruments. It should be noted that DGS' operating budget analysis includes committee narrative that addresses recommendation number three.

**DGS Response:**

*All energy savings under Energy Performance Contracts are guaranteed by the Energy Service Contractors, or ESCO. DGS also requires an energy savings bond or letter of credit to guarantee the savings, in case of a non compliance by an ESCO. We concur with the recommendation that (1) all bond sureties and letters of credit be reviewed by the State Treasurer's Office; (2) all BPW items clearly delineate whether the surety agreement has been reviewed by the State Treasurer's Office prior to submission to the Board; and (3) to submit an annual status report that includes the dollar value and the anticipated expiration and renewal dates of all surety instruments.*

## 6. 2100 Guilford Avenue

### **Recommendation (page 39)**

In light of the continued uncertainty regarding the Guilford Avenue facility, DLS recommends that the fiscal 2009 authorization be de-authorized as it is apparent that DGS and DPSCS are not prepared to proceed with this project at this time. DGS and DPSCS should seek funding from the legislature when the agencies have (1) resolved the issues surrounding the Guilford Avenue facility; or (2) found a suitable alternative site for the relocation of DPSCS.

### **DGS Response:**

Since 2005, the State and City of Baltimore have made a concerted effort to relocate the DPP operations from 2100 Guilford Avenue. A number of alternate locations have been explored without success. However, there are several new alternate locations under consideration that would enable the State to relocate the DPP operations units out of 2100 Guilford Avenue.

The fiscal 2009 authorization will be used to complete the work on the initial renovations to connect the two buildings together. The original project constructed an addition and installed a new boiler system that was to serve both buildings. The original building is still operating under the old boiler system that is original to the facility and in dire need of replacement. Once the connection is made, the old boiler plant is to be demolished.

In addition, a new main entrance was constructed but has not been finished. The stairwells are not complete, the ADA elevators for both public and employee access, are not in place. The corridors between the buildings have not been completed for fire rating and cannot be used for employee access between the buildings. The security system has not been upgraded as planned, and all bathrooms in the existing building were to be brought up-to-code for plumbing and ADA compliance.

While the search for an appropriate alternative location continues, it is in the best interest of the State to retain the fiscal 2009 authorization in place. Therefore, DGS opposes the DLS recommendation to de-authorize the funds. The justification for our opposition is supported by the opportunity presented once DGS and DPP have identified the new location for the operations currently at 2100 Guilford Avenue. This building will present an opportunity to back fill with another appropriate State Agency. This building will also present an opportunity to co-locate State and City agencies to provide necessary services to this community during its redevelopment phase. To have the opportunity to complete this, all renovations that are code requirements would have to be completed.