

HF3582 - 1E - Capital Project Replacement Accounts

Chief Author: **Fue Lee**
 Committee: **Capital Investment**
 Date Completed: **3/8/2024 9:09:37 AM**
 Agency: **Minn Management and Budget**

State Fiscal Impact	Yes	No
Expenditures	X	
Fee/Departmental Earnings	X	
Tax Revenue		X
Information Technology		X
Local Fiscal Impact	X	

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions shown in the parentheses.

State Cost (Savings)	Biennium			Biennium		
	Dollars in Thousands	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	145	45	45	
Total	-	-	145	45	45	
Biennial Total			145		90	

Full Time Equivalent Positions (FTE)	Biennium			Biennium	
	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	.36	.36	.36
Total	-	-	.36	.36	.36

LBO Analyst's Comment

I have reviewed this fiscal note for reasonableness of content and consistency with the LBO's Uniform Standards and Procedures.

LBO Signature: Susan Nelson **Date:** 3/8/2024 9:09:37 AM
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State Cost (Savings) Calculation Details

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions are shown in parentheses.

*Transfers In/Out and Absorbed Costs are only displayed when reported.

State Cost (Savings) = 1-2		Biennium			Biennium	
Dollars in Thousands		FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	-	145	45	45
Total		-	-	145	45	45
Biennial Total				145		
1 - Expenditures, Absorbed Costs*, Transfers Out*						
General Fund	-	-	-	145	45	45
Total		-	-	145	45	45
Biennial Total				145		
2 - Revenues, Transfers In*						
General Fund	-	-	-	-	-	-
Total		-	-	-	-	-
Biennial Total				-		

Bill Description

This legislation requires grantees receiving an appropriation of state money for capital improvement projects to establish:

- a capital project replacement fund to fund major rehabilitation, expansion, or replacement of the capital project once the project has reached its useful life, or, if approved by the granting state agency before the end of the project’s useful life, fund major rehabilitation, expansion, or replacement of the capital project or fund a capital improvement project for a different capital asset owned by the grantee, and
- a capital project replacement policy to govern the use of deposits in their respective capital project replacement fund for the options listed above.

The Commissioner of MMB must determine the annual minimum deposits to the fund, depending on the project type and other relevant factors. The State Auditor may audit any capital replacement fund accounts established by grantee but is not required to. Existing programs that have capital reserve requirements for maintenance, like the Water Infrastructure Funding Program in M.S. 446A.072, are exempted from this requirement. There is a penalty for grantees who do not comply with these new requirements equal to one percent of the state appropriation for each year of non-compliance.

Assumptions

The determination of annual deposits to each grantee’s capital project replacement fund will require the development of a formula based on the type and the nature of the asset receiving funding. This will require staff time above and beyond the normal scope of operations.

- MMB staff lack the necessary knowledge of construction and asset management to develop an objective measure to determine minimum deposits for these accounts. This will require the agency to contract with an outside consulting firm to develop a methodology that considers all the factors outlined in the legislation, at an estimated cost between \$50,000 and \$100,000.
- There will need to be ongoing data collection for all projects that receive state capital appropriations to be used in the calculation of annual minimum account deposits. At a minimum, we will need to collect data on the nature of the asset being funded, a measure of valuation, and estimated useful life. Additionally, we will need to review and verify data submissions are accurate and complete. We estimate this will take a minimum of 160 staff hours (at the State Program Administrator Principal (L14) level) annually and could increase depending on the final methodology determination.
- It is unknown at this time if MMB will need to create a new information technology (IT) tool, or modify an existing IT tool, to manage the collection of project data and to administer the proposed methodology. Due to the unknown need in this area, IT costs are not currently reflected in this fiscal note.

- Grantees will likely seek explanation and, in some cases, contest the calculation of the annual minimum deposit. The final calculation methodology will likely include variables with various valid interpretations. We anticipate some grantees will try to negotiate or contest MMB's determinations. Providing the analysis to each grantee and justifying the minimum deposit requirement determination may take 2 staff hours per grant. Depending on the number of grants appropriated in a capital investment bill and the number of grantees that will challenge the minimum deposit determination, which could add between 30-600 staff hours of staff time each year.

The legislation allows for exceptions for projects “under M.S. 446A.072 subdivision 12, or any other law, rule or ordinance, so long as the deposits into the replacement fund are at least as large as the minimum deposits established by the commissioner of management and budget under subdivision 2.” Based on current knowledge, only the projects funded under M.S. 446A.072 subdivision 12 would be exempt. All other projects would be subject to developing a capital project replacement policy and funding a replacement fund.

The legislation requires any grantee who does not establish these accounts with the required deposits to pay a penalty equal to one percent of the amount appropriated in each year of non-compliance. There will inevitably be instances where grantees do not comply, but not enough is known to develop an accurate estimate of the total amount of revenue generated by these penalties. Granting agency staff may need to expend additional time each year monitoring the status of the capital project replacement fund, determining whether to assess a penalty, and collecting the penalty.

Expenditure and/or Revenue Formula

Classification	Hours	Amount (Salary & Fringe)	FTE
State Program Administrator Principal	760	\$58.79 per hour including salary & fringe	0.36
	TOTAL	\$44,680	0.36

Long-Term Fiscal Considerations

None

Local Fiscal Impact

Any political subdivision receiving state appropriations that does not have a capital improvement plan (CIP) or similar asset preservation plan will be required to develop one prior to their receipt of a state grant. This will involve local staff time and/or possible fees to hire an outside consulting firm to develop a plan to meet this requirement.

Any grantee receiving state funds will be required to make annual deposits to their fund equivalent to the amount determined by the Commissioner of MMB. Grantees will need to identify funds and begin making the necessary deposits in the same year the grant agreement is executed. Any final methodology could take one of at least three approaches: (1) higher deposits in the early years to build up sufficient funds for future replacements; (2) equal annual deposits over the life of the project; or (3) lower initial deposits followed by higher deposits as the project ages. Grantees would need to identify a source of funding for deposits. It is unclear whether grantees could issue their own debt to fund them. If not, they would be required to identify funds from their operating budgets to make these deposits. Grantees will not be able to pass this requirement down to any third-party operators they contract with for the use and operation of the project, because 16A.695, subd. 2 would instead require a portion of the collected funds to be shared with MMB. MMB does not want revenues from third-party operators flowing to the state because it creates private use under federal tax regulations and could jeopardize the tax-exempt status of the state's debt.

The methodology to determine capital replacement fund deposits will likely consist of some portion or percentage of the value of the underlying asset, adjusted for aspects unique to the asset, and further adjusted for construction cost inflation. For illustration purposes, assume the methodology results in an annual deposit amount equal to 3 percent of the current asset value of the project receiving state money for capital improvement over a 20-year period. A city is requesting \$6,000,000 to update facilities at existing parks and their associated buildings and grounds. The valuation of the land and buildings these funds will be used to improve is \$15,000,000. The minimum annual deposit for this project would be \$450,000 without any adjustment for construction cost inflation, for a total of \$9,000,000 over a 20-year period.

References/Sources

none

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