

REPORT TO THE GOVERNOR BY THE INTERAGENCY WORKING GROUP FOR SCHOOL CONSTRUCTION

March 15, 2006

Pursuant to Executive Order #3, we, the Interagency Working Group on School Construction, submit this report of our initial findings and recommendations for your review. We find that major operational and programmatic changes are necessary to move forward with a school construction program that will efficiently and effectively build schools for our children. Moreover, we find that a recommitment to the broader purpose beyond the building of schools, which includes revitalization of communities linked to their urban planning and economic growth, is necessary. This report includes our initial findings and recommendations, which are set forth below. We expect to submit a follow-up report with additional recommendations and implementation steps by May 15, 2006.

Background

This report reflects the outcome of ongoing dialogue among members of the Working Group. Since its formation by Executive Order #3, the Working Group has expanded to include the active participation of the Commissioner of the Department of Community Affairs as well as senior staff to Working Group members. Importantly, this report also reflects the input of the members of the Citizens Advisory Panel also established by Executive Order #3. A listing of all these contributors follows at the end of the report.

Executive Order #3 expressly directs the Working Group to develop specific recommendations addressing the “reorganization of the SCC and in so doing to consider such options as creating a new educational facilities authority in the Department of Education or the Department of Treasury or by enhancing the capabilities of the New Jersey Building Authority.” The Executive Order also directs the Working Group to “develop recommendations for consideration by the Schools Construction Corporation and the Acting Commissioner of Education to provide immediate improvements in the operation and management of the Schools Construction Program...”

Under this direction from the Executive Order, the Working Group recognizes that there are two major components of our review. First, we have focused on the current state of operations and capabilities of the SCC, and made recommendations to address existing challenges. Second, we have compiled recommendations for proceeding with school construction projects in an efficient and prioritized order, based on educational necessities. The Working Group has discussed these topics in great depth, and plans to continue seeking input from interested constituencies.

Current State of the Program

In considering these issues, it is important to recognize the current environment in which the SCC operates as well to evaluate how the SCC is organized, managed, and prepared to carry out its role in achieving the goals implicit in the vision of the program. To date, the SCC has managed 587 school facilities projects, including 354 Abbott health and safety projects. Of these projects, 50 represented major facilities, including renovations and additions. In addition, 2461 grants to Non-Abbott school districts have been executed, totaling \$2.1 billion.

It is also important to recognize that the SCC is currently managing approximately \$3 billion in ongoing work. This ongoing work includes 69 projects currently in construction and a group of 59 projects that were included in the capital plan of the SCC in July 2005. Completion of this ongoing work is complicated by the uncertainty surrounding the future of the organization. This uncertainty affects the recruitment of a permanent CEO and other senior management positions, as well as retention of key current personnel. Notwithstanding these challenges, immediate attention is being paid to address weakness in the management depth and operation of the SCC while at the same time developing ongoing reforms.

Several of these recommendations are based on our review of past practice at the SCC. Initially, it should be noted that the SCC was not structured in a manner that would allow it to concentrate primarily on the construction of school facilities projects. Additionally, the program elements as originally designed can best be described as misconceived and flawed. The legislation, while launching a pioneering effort to build schools, does not permit enough flexibility in how land is acquired or schools are built. Moreover, while funding was provided to launch a significant program, it was never sufficient to address the entirety of need throughout the state nor did the funding sufficiently contemplate the complexity and costs of actually constructing facilities in our urban centers. The speed with which a project could be constructed became the primary driver for the Corporation's activities. Management, accountability, reporting, cost control and transparency all took a secondary priority, if recognized at all, to speed. The result is also well known.

The path to reform began under Governor Codey. During the last eight months significant progress was made in the establishment of financial controls and reporting systems. However, much more needs to be done.

Looking Ahead

As we look ahead, an assessment of these issues and the needs of the corporation must start with an articulation of the role that the SCC or any successor organization will be called upon to fulfill. The Working Group believes the answer is clear, yet historically not followed. That is, there should be an organization that is focused on and has the capability to provide for the design and construction of facilities. Most importantly, the task should include the capability to offer a suite of alternative means to deliver such

services in collaboration with the Department of Education (“DOE”), local Boards of Education and their communities.

The Working Group emphasizes that the New Jersey school construction program is much more than the activities of the Schools Construction Corporation. The management and operation of the SCC has dominated public discussion related to the program. This focus has distracted public inquiry from assessing the underlying vision of the program: to invest in our children and their communities by providing quality educational facilities that contribute to the vitality of the community. These quality educational facilities should stimulate economic growth, broaden opportunity, and enhance neighborhood development. As such, school construction is much more than an infrastructure program that constructs facilities. Where major new facilities are contemplated, the program can serve as a catalyst for community and land use planning. These initial findings and recommendations and our forthcoming findings should be considered within the context of these broader goals.

In order to move toward the future, immediate steps must be taken to improve the day-to-day management of the SCC. This process is already underway and will result in a restructuring of the organization in the coming months so as to create a management system that can effectively and efficiently implement the goals of the school construction program. A critical initial step is the selection of a permanent CEO. We have commenced a nationwide search for candidates with the management skills and background necessary to successfully run the SCC. The current circumstances of the Corporation pose serious challenges to this recruitment effort, but we remain optimistic that the importance of this program to the State, and the professional challenges inherent therein, will produce attractive candidates. At the same time, we are also actively searching for a professional to serve as the Corporation’s CFO.

While the findings and recommendations that follow recommend abolition of the SCC and replacement with a new agency exclusively devoted to the construction of school facilities, we do not view this as an insurmountable impediment to our recruitment efforts. We anticipate that operational improvements and improvements in management structure in the short term can be migrated to a new authority, if established. It is also critical that the current organization be empowered to continue the work underway, which includes management of over \$3 billion of ongoing projects.

In addition to considering options for restructuring of the organization, the Working Group will develop a project prioritization approach over the next several weeks. Two different, but related, prioritizations need to be developed. First, it is expected that there will be a shortfall of as much as \$300 to \$400 million in funds to finish all of the projects in the current capital plan, which includes projects in construction, projects in design and demonstration projects. Of this amount, approximately \$300 million represents the amount needed to complete the list of 59 projects approved in July 2005. Of this \$300 million, approximately 45% is driven by the impact of inflation since the original cost estimates. Therefore, a prioritization needs to be developed for the sequencing of the 59 projects. While we assume that any new

funding authorized by the legislature will go first to finish projects in the capital plan, prudent management dictates that the SCC sequence these projects in recognition that such funding may not be forthcoming for some time.

The calculation of the shortfall reflects the results of an ongoing effort to quantify costs that were not known or reflected when the capital plan was adopted in July 2005. The capital plan was based upon project estimates, not refined budgets, and as such did not reflect precise costs for inflation, land acquisition, relocation and new building security requirements. Therefore, it would be incorrect to view this shortfall estimate as a budget overrun. It is also important to recognize that the actual costs may be less than this estimate as actual costs become verified. The reality of this situation underscores the need for improved forecasting and more rigorous cost controls. However, it is also essential that this appropriate emphasis on cost not result in a diminution of the quality of school facilities that are designed and constructed through the school construction program. We need to recognize that the facilities we are constructing today will be serving our educational needs for generations to come, and accordingly must be designed and constructed to satisfy that test of time.

The second prioritization will focus on projects that were previously approved by the DOE and how they may be affected by the recently-submitted 2005 Long Range Facilities Plans (“LRFP”). DOE and each district need to reach an agreement on the priority for projects that might realistically be implemented during the next 5 years, assuming that funding is made available.

These prioritizations should be based upon educational needs, the Supreme Court’s directives and the reality of construction schedules. In addition, an assessment should be made regarding how the 59 projects in the Capital Plan interact with additional projects in each of those districts as part of the 2005 LRFP process. The DOE, consistent with the directives contained in Executive Order #3, has already begun to play a more prominent and appropriate role in the integration of educational policy and prioritization with the school construction program.

Finally, before any additional funding is sought or authorized, it is critical that an organization be in place that can be entrusted to properly administer additional projects and funding. At such time as the organization’s internal controls and management system are properly reformed, we will recommend the undertaking of a collaborative process with stakeholders and the Legislature to initiate additional funding and legislative initiatives to further improve elements of the program as described below.

Thus, the focus of the Working Group in the coming weeks will be to ensure the reorganization of the entity administering the program, as well as to ensure that the prioritization of projects is guided by proper criteria.

A summary of our initial findings and recommendations follows:

FINDINGS AND RECOMMENDATIONS

Corporate Framework:

Findings:

- The activities currently managed by the SCC would be better managed if structured within an agency dedicated solely to the management of school construction with a governance and oversight board, the members of which are selected based on their specific background and knowledge of the activities of the Authority [“New Authority for Schools”].
- Until the transition to a New Authority for Schools is completed, the SCC must continue to operate and manage the \$3 billion in projects that are currently ongoing.

Recommendations:

1. The responsibilities now vested in the Schools Construction Corporation should be transitioned to a new authority that is located, in, but not of, the Department of the Treasury.
2. The transition must take place in such a way so as to enable the continued management of the \$3 billion in ongoing projects.
3. A transition plan will be developed by the Working Group, working with SCC and other stakeholders, to determine the appropriate corporate governance structure for the New Authority for Schools, as well as a migration path to transfer the existing construction projects.
4. Specific initiatives to address the shortcomings in the current organization need to be taken as quickly as possible and include:
 - a. Recruitment of a permanent CEO and CFO for the SCC;
 - b. Reorganization of the management of the Design & Construction Division to assure accountability, transparency and cross-function communications;
 - c. Enhancement of the project information systems to provide meaningful and timely budget and construction status reports, and finalization of a plan for migrating to a real project management information system;
 - d. Enhancement of the internal legal functions within the SCC so as to assure proper execution and monitoring of contractual relationships, as well as strengthened coordination with the Department of Law and Public Safety for pursuing allegations of fraud and contractual defects;

- e. Enhancement of communication and collaboration with all stakeholders.

Programmatic Objectives:

Findings:

- The Department of Education, working with the local school districts, needs to complete its assessment of the 2005 Long Range Facilities Plans [“2005 LRF”], incorporating the most up to date view of Facilities Efficiency Standards [“FES”], in order to prioritize which school facilities need to be funded.

Recommendations:

1. Based upon educational objectives and the local community’s ability to absorb such facilities, the DOE should assess, in consultation with local Boards of Education, the ordering of the 2005 LRF approved projects for the next 5 years so that the New Authority for Schools can develop a realistic Strategic Plan.
2. In those communities where major new facilities will be funded, there should be a comprehensive community effort to incorporate the investment in new facilities into the framework of an urban plan.
3. Common elements of design, engineering and architecture should be encouraged and incentivized, utilizing the advice of prominent specialists, to minimize the duplication of efforts and waste of resources which has occurred.

Enhancing Collaboration and Community Involvement:

Findings:

- The term “schools construction” contains various programmatic responsibilities, which should be disaggregated so as to allow them to be most efficiently prosecuted within State government. These responsibilities can be categorized as follows:
 1. Construction and renovation of schools in school districts where the State will have the construction management responsibility [“State Built”];
 2. Providing grant and technical construction assistance and oversight to school districts which will manage their own construction projects [“State Advised”]; and

3. Providing only grants-in-aid to school districts which will manage their own construction projects [“Grants”].
- Some school districts whose construction is currently managed by the SCC are capable of overseeing and managing construction of their own local projects in amounts greater than the current limit of \$500,000.
 - If we are to achieve the objective of using major new facilities as an economic driver of growth in our communities, then the communities themselves must have not only the major voice in developing the plan, but also a major economic contribution to the project’s vitality.
 - The municipal planning process generally does not adequately integrate the planning for and siting of schools.
 - Some municipalities have been reserving land for schools despite uncertain construction schedules, resulting in disruption to the municipal planning and development process.

Recommendations:

1. The first two categories, “State Built” and “State Advised” should be collected within the New Authority for Schools, which will have the appropriate construction management, land acquisition and urban planning expertise to fulfill the programmatic mission.
2. The “Grants” activity, assuming it continues in the future, should be sited within the Department of Education.
3. “State Advised” projects would contemplate allowing local school districts to oversee and manage the construction of projects, in an amount to be determined, but meaningfully greater than the current limit of \$500,000, with project management and other technical assistance being provided by the New Authority for Schools, and money only being released against agreed milestones.
4. The New Authority for Schools should not have the sole responsibility for acquiring the land for major new facilities. Rather, the development of a framework to share this responsibility with the local communities is necessary. One approach to consider would be for the school board to provide the land for the building of its schools.
5. Consideration should be given to requiring municipalities to include school facilities in their Master Plans, with such inclusion being part of

the evaluation of the Long Range Facilities Plans submitted to the Department of Education.

Additional Funding:

Findings:

- There remains a significant number of school facility projects to be initiated and completed. This will require the development of funding requirements for both Abbott and Non-Abbott district projects.

Recommendations:

1. No additional funding should be authorized for school construction activities until the corporation's operations and management have been further strengthened and new systems developed to address issues of enhancing cost control and collaboration with boards of education and their communities.
2. The DOE and SCC will work to develop a process for prioritizing the implementation of the remaining projects in the capital plan. To the extent that sufficient funding does not exist to finish all projects, a strategy needs to be developed which i) sequences the projects based upon available funds; and ii) anticipates how these projects would be ordered if additional funding is forthcoming.

Pursuit of Legal Claims:

Findings:

- The Attorney General has announced her withdrawal as a member of the Board of Directors of the SCC. This action was taken to avoid any conflict between her role to provide legal advice, conduct investigations, or pursue legal proceedings, including prosecution, in matters involving the SCC.
- The Attorney General, through the Division of Law, the Division of Criminal Justice, and the Office of Government Integrity ("the Attorney General") is actively providing assistance to the SCC to review the adequacy of contracts entered into by the SCC and to commence legal proceedings as may be appropriate. In that regard, the following activities are underway:
 - The SCC, in conjunction with the Attorney General, is reviewing all change orders to identify errors and omissions and assess the legal sufficiency of potential claims so that in appropriate cases, the

Attorney General can initiate a recovery process that may involve litigation.

- The Attorney General is reviewing contracts between the SCC and Project Management Firms (the “PMFs”) in order to determine whether the agency has over-paid for certain items and, where appropriate, to implement a strategy for recouping such money through set offs against future payments to the PMFs, demands for reimbursement or litigation. This review is being expanded to identify opportunities to improve the terms and conditions of contracts between the SCC and PMFs.
- The Attorney General is reviewing projects to identify any sites for which the SCC spent money on environmental remediation of school sites where the full value of that money was not already considered in formulating the purchase price. The Attorney General will initiate cost recovery actions where appropriate.
- Processes have been reviewed and revised to strengthen investigations by law enforcement agencies with regard to the interaction of the SCC with contractors and other third parties.

Recommendations:

1. An Executive Order should be issued to initiate the process to remove the Attorney General as a member of the Board of Directors of the SCC.
2. Although changes in the governance of the SCC are anticipated, the current activities of the Board would be enhanced by the appointment of an individual with a law enforcement background.

Next Steps:

The Working Group will be consulting with the Citizens Advisory Panel and other constituencies to:

- a. Begin implementation of these recommendations;
- b. Prepare a recommendation for next stage funding to be included in the next report, which will be based upon the application and development of a methodology to prioritize among projects;
- c. Develop recommendations for legislation that may be required to implement the recommendations; and
- d. Develop the transition plan for establishing the New Authority for Schools.

The Working Group will provide additional recommendations in its next report to be submitted on May 15, 2006. This report will address prioritization, proposed funding levels, and the status of the transition plan.

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