

**DEPARTMENT OF THE TREASURY**  
**FY 08 INTERDEPARTMENTAL QUESTIONS**

**DISCUSSION POINT**

State employee compensation represents a significant portion of State operating expenditures. In FY 2008, the Governor's Budget projects that to employ approximately 80,000 State workers it will cost \$5.6 billion in compensation, of which about \$3 billion is included in Direct State Services appropriations. The proposed Governor's Budget recommends an increase of \$212.8 million for Salary Increases and Other Benefits for compensation increases that accrue in FY 2008 for the portion of the State workforce considered "State funded," i.e., not funded by federal or dedicated revenues. Factors influencing this recommended funding level include a three percent cost-of-living adjustment (COLA) negotiated with some unions representing State employees, step increments, the annualized impact of mid-2007 COLAs, projected savings from management efficiencies, and projected unused sick leave payments. In past years, recommended funding levels have assumed the availability of unexpended prior year balances.

FY 2007 Adjusted Appropriation and FY 2008 Proposed Governor's Budget Salary Increases and Other Benefits (\$ millions)		
	FY 2007 Adjusted Appropriation	FY 2008 Recommended Appropriation
Salary Increases and Other Benefits	\$ 0.0	\$237.8
Management Efficiencies	0.0	(\$25.0)
Unused Sick Leave Costs	\$10.3	\$10.3
Total	\$10.3	\$223.1

**QUESTION 1A**

Please discuss the need for policies and plans for long term controls on the various components of compensation costs of State employees. Are there any compensation studies underway? Please define what benefits are included in "Other Benefits" and "deferred costs." Please explain why \$25 million was determined to be the cost reduction for Management Efficiencies. Please itemize, by Executive and Judicial employees, the specific funding components that make up the recommended \$237.8 million for Salary Increases, e.g., deferred COLA, new COLA, and step increments. What amount, if any, of unexpended balances from FY 2007 are anticipated to supplement FY 2008 appropriations? What

number of retirees and what average payment is assumed to justify the amount recommended for unused sick leave payments?

#### **ANSWER 1A**

Compensation costs are a significant portion of the State's direct state services budget and impacted by collective bargaining agreements. Recent contract negotiations between the State and representatives of its public employees show a commitment from the Administration to control employee benefit costs.

"Other Benefits" can include clothing and tool allowances, bonuses, and cash in lieu of payments. Deferred costs are the annualized costs of increases provided in the previous fiscal year.

The \$25 million was the estimated annualized savings from continuation of the current hiring freeze and other management efficiencies. It is expected that as a result, the state funded workforce will be reduced an additional 500 positions.

The recommended appropriation of \$237.8 million is before the \$25 million reduction for management efficiencies. It includes projected cost of living adjustments (COLA) and increments of \$120.7 million, deferred COLA of \$27.7 million, restoration to the base of \$26.1 million of FY07 allocations from carry forward balances, \$21 million for merit increase/salary compression programs for managers and attorneys and other adjustments of \$7.6 million for the Executive Branch. \$34.7 million is included for the projected amount required for progression and COLA increases for the Judiciary, which will be impacted by the addition of the 10<sup>th</sup> step in FY08.

The recommended appropriation of for unused sick leave of \$10.3 million would provide 1,200 retirees an average payment of \$8,583, the average paid to date in FY07.

#### **DISCUSSION POINT**

The Commissioner of Personnel's power to fix and revise employee compensation is now limited to that of administering a State employee compensation plan which has been negotiated with State employee labor unions through the process of collective bargaining. Prior to 2001, the State had negotiated informally with its employee unions on a range of issues concerning State employee compensation such as the provision of an annual COLA which the commissioner incorporated into the State employee compensation plan. However, P.L.2001, c.340, makes a broader range and scope of issues negotiable. Not only

can annual COLAs be negotiated but other significant issues, such as the number of steps in a range and how an employee moves between steps and between ranges, can also be negotiated.

### **QUESTION 1B**

Please describe the current collective bargaining process, in detail, for establishing a compensation plan of salaries and other benefits for employees. Please identify the most important issues that are negotiated in the process. What other terms are negotiated in the contracts? Please explain what the process was to add a tenth step in 2006 to salary ranges. What were the assumed costs and benefits of adding a tenth step to the salary range? Why is a tenth step proposed to be added to the Judiciary step increments in FY 2008? Are there any pay raise formulas in statute or in collective bargaining agreements that provide automatic pay raises to any represented employee group before negotiated agreements are ratified? Please identify which employee benefits are statutorily required and which are negotiated in the collective bargaining process. What is the current status of all the bargaining agreements with State employees? How, when, and in what detail is the Legislature notified about any collective bargaining process and its results?

### **ANSWER 1B**

In the current collective bargaining process, the parties started from the existing compensation plan of salaries and benefits for employees and negotiated changes. There were no additional steps added. The significant changes to compensation were the across-the-board increase ("ATB") that were agreed to by CWA, AFSCME and IFPTE, the increase of 0.5 points in pension contribution; and, the health care contribution at 1.5% of salary effective in the first pay period after 7/1/07. The ATBs are 3.0, 3.0, 3.5 and 3.5 for the four years of the contract. The important issues in the process include wages, the pension contribution increase and the significant changes to the health plan, including the health care contribution by all employees at 1.5%, the increase in doctor and ER co-pays, the elimination of Traditional Plan, and the increased co-pays for brand name prescription drugs.

The other terms negotiated in the contracts are changes in terms and conditions, including discipline terms, union rights, and other changes to language, including side letters to the agreement that involve ongoing processes to address issues raised by the parties.

With regard to the process to add a tenth step in 2006 to salary ranges, that was done as part of the negotiation of the 2003-2007 agreement.

The cost of the addition of the tenth step in the year of implementation (FY07) was estimated at \$49.4 million, \$31.4 million of which was state supported. The tenth step at Judiciary is a product of collective negotiations, and is consistent with the pattern set by the 2003-07 contract.

This question as posed is difficult to answer. Automatic pay raises are not in any negotiated agreement. The step and range guide is in the Compensation Plan set by civil service. In accord with PERC decision law, such increments are generally continued while there is an open period.

Pension and health benefits are currently set by statute and certain benefits are also negotiated in the collective bargaining process. Pensions benefits have to be legislatively changed and the legislation will be consistent with the changes agreed to as part of the collective bargaining process. The health care contribution and the changes in co-pays and deductibles were negotiated.

The current status of bargaining agreements with State employees is that there is a ratified agreement with the CWA, that AFSCME should have completed its ratification; and that IFPTE has reached a tentative agreement with ratification voting on May 23 and 24. All three of those agreements follow the CWA pattern. At this time, the State is negotiating with the AFT locals for adjuncts and full time faculty and employees. In addition, we are in the process of negotiating with the Law Enforcement Units (primarily Corrections), including the PBA 105 and Superiors represented by the FOP. The agreements with the State Police run through June 30, 2008. The agreement with the Judiciary also runs through June 30, 2008. These are not being negotiated at this time.

The Legislature is notified about collective bargaining agreements. Negotiations are private, by necessity, and the parties committed to keep discussions and developments confidential so as to ensure progress. This ultimately resulted in the CWA pattern deal which achieved the State's goals.

## **DISCUSSION POINT**

Salary compression of State managers is an ongoing issue. Salary compression occurs when a manager's salary is less than \$2,000 more than the highest paid employee directly reporting to him/her. Disparate growth in salaries between managers and subordinates causes salary compression. Since June 2001 there have been no "programmatic" management salary increases authorized.

However, the FY 2005 Appropriations Act budget language directed the State Treasurer to establish directives governing salary ranges, rates of pay, and salary increases, including a 3.9 percent COLA for public sector managers. Instead, the public sector managers received a 2.9 percent COLA, effective June 26, 2004, which was consistent with State-negotiated contracts.

### **QUESTION 1C**

What are the continuing underlying causes of salary compression? What barriers exist that inhibit the resolution of the issue? Have the Governor's Office and the Department of Personnel finished their review of salary compression, as indicated in last year's response to an OLS Discussion Point, and if so, what were the findings and conclusions?

### **ANSWER 1C**

Salary compression occurs when the negotiated increases for cost of living adjustments and increments for employees under collective bargaining agreements allow represented employees to obtain annual salary increases that exceed the raises provided managers. As noted above, the FY08 budget recommendation includes \$21 million for merit increase/compression programs for managers and attorneys. Agencies have been asked to identify the criteria that would be used to provide managers merit increases of up to 6% and to identify those that would be eligible for a compression increase of up to \$2,000 after that merit increase. Plans are due to the Department of Personnel by May 23, 2007.

### **DISCUSSION POINT**

Current law provides that State employees and the employees of an independent State authority, board, commission, corporation, agency, or organization may be required to contribute toward the cost of State Health Benefits Program (SHBP) coverage, in accordance with the terms of collective negotiations agreements. The State is also responsible for payment of the full or partial cost of post-retirement medical benefits under SHBP for qualifying retirees and their dependents. The proposed FY 2008 Governor's Budget recommends a net Direct State Services increase of \$54.9 million for health benefits costs for active and retired employees. This amount results from significant increases and decreases in the various components of health benefits. For example, funding for the State Employees' Prescription Drug Program is projected to increase by \$78 million, funding for post retirement medical benefits is projected to increase by \$12.9 million and State Health Benefit Program payments for active employees is projected to decrease by \$35.6 million. In FY 2008, budget language requires all

active State employees, including those of colleges, to contribute one and one-half percent of their salary towards their health benefits. This language reflects a collective bargaining agreement the Governor reached with certain State employee unions.

## **QUESTION 2A**

Please itemize the components of change from FY 2007 to FY 2008 in recommended funding for State Employees' Health Benefits, the State Employee's Prescription Drug Program and post-retirement medical benefits, respectively. Please explain the fluctuation in the appropriations for the State Employees' Prescription Drug Program from FY 2006 (\$189.7 million) to FY 2007 (\$107.4 million) to proposed FY 2008 (\$185.4 million). Please quantify the assumed impact of the proposed one and one-half percent health benefit contribution. Please explain in what manner and when the employees' health benefits contribution is proposed to be increased in FY 2008. Please identify which employees or classes of employees this contribution would affect, when it would affect them, and how it would change the portion of premium now paid. What is the estimated need over the long term for premium sharing by employees and increasing that share?

## **ANSWER 2A**

The reduction in funding for medical benefits for active State employees is largely attributable to the employee premium sharing requirement. The estimated savings in State contributions as a result of this change is \$58 million. Also contributing to the reduction in FY 08 is the increase in co-payments for doctor visits. The estimated savings from the higher co-pays is \$3.7 million.

The increase in the funding for post-retirement medical benefits of \$12.9 million is due to higher premium rates and an assumed increase in membership of 4.9%.

The increase in funding for prescription drug coverage of \$78 million is primarily due to the use of reserves in FY 2007 to fund a portion of the required State premium contributions. The FY 07 appropriation reflects savings of \$60 million from fund balance utilization. There were also reductions in FY 07 for other savings initiatives including \$11.5 million from bulk purchasing, \$11 million from mandatory mail-order service, \$9 million from mandatory use of generic drugs and \$3 million from pharmacy administration. These other savings initiatives were not implemented. The increase in the appropriation is also due to a projected rate increase of 11% effective 1/1/08. Membership is assumed to remain

level between FY 2007 and FY 2008. The projected increase of \$78 million is net of anticipated savings of \$8.3 million from increased co-payments for prescription drugs effective 7/1/07.

The fluctuation in the appropriations between FY 2006, FY 2007 and FY 2008 is mainly due to the offset to the FY 2007 appropriation for the above stated savings initiatives.

The increased contribution, 1.5% for all plan participants, will be effective with the first paycheck in FY08. As far as we know, this change will impact those covered by the CWA and AFSCME collective bargaining agreements, effective July 1, 2007, and non-aligned employees in these same units. Other units may be impacted as their contracts are negotiated and ratified.

As far as the future estimated need for premium sharing, we can only cite what has been collectively bargained.

## **DISCUSSION POINT**

Currently, the State Health Benefits Program (SHBP) is a self-insured, multiple option program offering health benefits coverage through an indemnity plan (Traditional Plan), a State point of service (POS) managed care plan (NJ PLUS) and five health maintenance organizations (HMOs). Indemnity plans are no longer a customary offering in the health care industry and the preferred provider organization (PPO) has become a more prevalent managed care form than the POS. A PPO does not require designation of a gatekeeper physician or the use of referrals. It is a network of doctors and hospitals whose services are available with a small co-payment, with a higher charge for use of providers outside of the network. The Division of Pensions and Benefits has recommended that a PPO replace the Traditional Plan and NJ PLUS with the goal of securing more competitive bids for SHBP's contracted administrative services by providers operating on a national basis. In addition, as noted above, the Governor has announced agreements with certain State employee unions and members of the New Jersey Education Association to have employees contribute one and one-half percent of their salary toward the cost of SHBP coverage.

## **QUESTION 2B**

If a PPO replaces the Traditional Plan and NJ PLUS, what is the amount of savings anticipated for the State and for local employers participating in SHBP? Do the estimated savings assume a continuation of premium sharing by

employees? If so, what is the separate estimated savings resulting from anticipated premium sharing?

## **ANSWER 2B**

While there are savings associated with the elimination of the Traditional Plan for State employees, the elimination of the gatekeeper in NJ PLUS, which has a much larger State employee enrollment, is expected to be an offsetting cost. For State employees, most of the medical plan cost savings known at this time will come from other plan changes (such as increases in office visit and emergency room co-pays). The primary source of State savings is therefore attributable to negotiated increases in office visit and prescription drug copays and employee premium-share.

Savings for local employers participating in the SHBP, should they be impacted by this change, will vary by employer depending upon their current employee distributions in the NJ PLUS and Traditional Plan, and cannot be quantified at this time.

The value of the 1.5% for all state employees including colleges and universities is approximately \$91 million for FY08. However, the current premium-sharing arrangement produces approximately \$33 million, for a net savings of \$58 million under the new premium-share scenario.

## **DISCUSSION POINT**

The FY 2007 budget projected savings in the State Employees' Prescription Drug Program and other prescription drug programs attributable to cost containment measures. At the time, these measures and their estimated savings included bulk purchasing of pharmaceuticals (\$23.5 million), mandatory mail-order for maintenance drugs (\$11 million), mandatory use of generic drugs (\$9 million), and improved pharmacy administration (\$6.1 million). In the response to a FY 2007 Discussion Point, the department indicated the SHBP was prepared to release a Request For Proposal (RFP) to contract directly with a Pharmaceutical Benefits Manager (PBM), and this recommendation came from the 2005 Benefits Review Task Force Report.

## **QUESTION 2C**

What is the status of the use of a Pharmacy Benefits Manager? What is the status of an RFP for this purpose? Which of the projected FY 2007 savings were realized?

## **ANSWER 2C**

The Division is currently in the preliminary stages of preparing a Request for Proposal for a Pharmacy Benefits Manager. The initiatives, with respect to mandatory maintenance and generics were not implemented; instead a market-oriented approach was adopted through negotiations, and savings related thereto have been estimated at \$8.3 million. The remaining items will be subjects for a Pharmacy Benefits Manager.

## **DISCUSSION POINT**

Prior to the passage of P.L.1994, c.62, members of the Public Employees' Retirement System (PERS) and members of the Teachers' Pension and Annuity Fund (TPAF) made employee contributions as a proportion of compensation at rates that differed according to the employee's age at the time of enrollment, but did not increase during the continuation of membership. P.L.1994, c.62 provided for a uniform rate of contribution of 5 percent of compensation. All PERS and TPAF members enrolled on or after July 1, 1994 paid 5 percent immediately. Members enrolled prior to July 1, 1994 paid 5 percent as of the beginning July 1, 1995, as specified. However, if the member's contribution rate was less than 6 percent, then the member's contribution rate phased in from 4 percent beginning on or about July 1, 1995 to 5 percent at the beginning July 1, 1996, as specified.

P.L.1997, c.115 provided that the PERS and TPAF employee contribution rate would decrease to 4.5 percent from excess valuation assets for calendar years 1998 and 1999. Thereafter, those rates could be reduced by not more than 0.5 percent from excess valuation assets if the State Treasurer determined that excess valuation assets would be used to reduce the State and local employer normal contributions. P.L.1999, c.415 further reduced the PERS employee contribution rate to 3 percent from excess valuation assets for calendar years 2000 and 2001. For those same calendar years, P.L.2001, c.133 provided that the TPAF employee rate was reduced to 4.5 percent. Both laws provided that the rate might be reduced from excess assets by not more than 2 percent. The PERS and TPAF rates thereafter were 3 percent. The employee contribution rate for PERS members returned to 5 percent for State employees on July 1, 2004 and for local employees on January 1, 2005. The TPAF member rate returned to 5 percent on January 1, 2004.

The Governor has announced agreements with certain State employee unions and members of the New Jersey Education Association to increase the PERS and TPAF employee contribution rate to 5.5 percent.

### QUESTION 3

What is the estimated increase in State and local employee contributions, respectively, to each pension system from the additional one-half percent increase? Please identify which employees would be affected by this additional pension contribution and when it would take effect. In which State fiscal year will the impact of higher employee contributions first affect employer contributions? What is the estimated impact on State and local employer contributions, respectively, by system, in each of the first five fiscal years of impact? Please discuss the long term need for this increase in employee contributions and whether there will be a point at which it will no longer be needed. Has the FY 2008 level of the State's employer contributions—50 percent of full funding, compared to 57.5 percent in FY 2007---been influenced by the assumption of the future impact of higher employee contributions, and if so, to what extent and with what justification? If the State is allowing this factor to influence its current contribution, why should local employers not be accorded the same leeway?

### ANSWER 3

The estimated increase in additional annual employee contributions for the first year is as follows:

PERS-State	\$22.83 million
PERS-Local	33.65 million
TPAF	44.57 million

These amounts are expected to grow each year in conjunction with the growth in total pensionable salary.

Currently, as far as we know the only group affected by the additional pension contribution identified to date is limited to State employees.

With regard to the effect on employer contributions, it is still to be determined whether the additional employee contributions will be used to reduce annual employer contributions.

Pending legislative action, it is intended to be a permanent increase and this increase in coupled with the increase in State funding will hopefully improve the systems' funded status.

The impact of higher employee contributions was NOT considered in arriving at the 50 percent level of funding for State pension contributions for FY 2008.

## **DISCUSSION POINT**

According to the FY 2008 Budget in Brief, the Bureau of Risk Management (BRM) in the Department of the Treasury is gradually implementing numerous management reforms for the State's Workers' Compensation program, based on the suggestions of a 2005 consultant's report to the department. One key suggestion was to expand BRM's investigative staff so that the overall administration of claims could be improved. Accordingly, BRM hired seven new investigators, thereby doubling the existing investigatory staff. A direct result of this was a 9 percent decrease in the number of Workers' Compensation claims reported for FY 2006, as compared to FY 2005, and the trend has continued into FY 2007. Notwithstanding this decrease, Workers' Compensation Self-Insurance Fund expenditures grew from \$56.7 million in FY 2005 to \$63.6 million in FY 2006, and are projected to total \$67.2 million in FY 2007. The FY 2008 Governor's Budget recommends \$64.7 million for this purpose, a reduction of \$2.5 million below FY 2007.

## **QUESTION 4**

What explains the increase in expenditures over the FY 2005-2007 period despite the reported decrease in claims? Please explain how many investigative staff need to be retained to sustain progress in investigating Workers' Compensation claims. How much more progress can be anticipated in investigating such claims? Is there a goal being sought and after it is achieved, is the same level of staffing necessary? When can the level of staffing be expected to be decreased? What other suggested reforms were offered in the consultant's report to the department in 2005? Have any of these been implemented? If so, which ones? Please provide information on the cost and savings impact of the implemented reforms, both actual and projected. If all suggested reforms were not implemented, why were certain ones excluded?

## **ANSWER 4**

The increase in worker's compensation claim expense during FY 05 - FY 07 can best be explained by the comprehensive course of action of the process. Medical treatment can extend for a period of years, litigation takes about two/three years, and a more aggressive effort by the petitioner's bar to file motions

for medical and re-open closed litigated claims for additional permanent disability benefits are factored into the process and effect overall costs.

In FY 05, the Bureau was able to hire two additional Deputy Attorneys General to deal with the extensive backlog in litigation. At that time, the total legal staff consisted of seven trial attorneys as compared to four in FY 02. This resulted in settling more cases with a corresponding rise in the cost of permanent disability paid in subsequent fiscal years despite the reduction of claims filed within those years. The Bureau presently has five attorneys assigned to litigation and is working with the Division of Law to replace the two who have left.

The downward trend in the actual filing of claims is the result of hiring seven additional investigators to the existing investigative staff in late FY 05. These additional investigators allowed the Bureau of Risk Management to increase field investigations, improve the overall administration of claims, and allow for more reasonable caseloads to correspond to industry standards. Unfortunately, in the past year five investigators have resigned. Without administrative relief claims will increase and subsequently, costs will rise. The worker's compensation process, given the lucrative nature of the benefits, the social welfare nature of the statute, and a very active petitioner's bar, gives rise to claims situations that needs immediate investigative attention. Demands for benefits are made and timely responses must be made by the Bureau's investigative staff. As such, it is imperative that attrition in this area be addressed to continue the positive trend of claims reduction.

During the summer of 2005, a study of the Bureau of Risk Management was conducted by the Public Entity Risk Management Administration, Inc. A report dated August 25, 2005 was submitted to the Treasurer's Office. To date the Bureau has implemented the following initiatives:

- Establishment of a joint SLI determination function with the Department of Personnel
- Submission of a plan for Tort reform
- On going program with the Division of Revenue for the collection of old subrogation claims
- Submission of a plan for coordination of benefits for tax purposes for workers' compensation temporary disability payments and SLI
- Availability of Report Manager with current loss and payment information to enable the various appointing authorities to have access to claims information for their agencies to assist in loss control at the agency and help identify repeat offenders, "hot-spots", etc.

- Hiring and training of seven new workers' compensation investigators to cope with heavy claims volumes

Recently the Legislature passed legislation which enacts the Bureau of Risk Management to be established as a Division, with immediate supervision under the direction and supervision of the State Treasurer with a Director appointed by the Governor with the advice and consent of the Senate. As evidenced by the passing of this legislation, both the Administration and the Legislature have recognized the importance of claims management, safety/loss control and risk finance as a priority in managing the State's workforce, providing for a safe work environment and controlling claim's costs accordingly. Once the Director has been named, possibly many of the proposed recommendations that were made in 2005 can be further reviewed and implemented.

## **DISCUSSION POINT**

For several years the State has used cash flow borrowing, in the form of tax anticipation notes, to meet its cash flow needs in the early part of the fiscal year, when cash spending outpaces cash collections. This situation largely results from the need to expend significant sums on local aid and direct property tax relief in the first two fiscal quarters, before major tax collections are received in the last two fiscal quarters. A FY 2008 appropriation of \$10 million is recommended for Interest on Short-Term Notes (page D-493), a decrease of \$22 million below the FY 2007 appropriation for this purpose. Thus far in FY 2007, the State has issued \$1.75 billion in tax and revenue anticipation notes (TRANs) to meet cash flow needs. Interest costs on these notes will total about \$56.2 million, which will be offset by original issue premiums of \$12.4 million. Thus, net interest cost will total approximately \$43.8 million. Investment earnings will supplement FY 2007 appropriations of \$32 million to fully fund these costs.

## **QUESTION 5**

Will additional TRANs be issued in FY 2007? If so, in what amount and at what projected net interest cost? Does the recommended reduction in appropriations for short-term interest signify a permanent improvement in the structure of the State's cash flow? What projections of FY 2008 tax and revenue anticipation note issuance (per amount and date of sale), total and net interest costs, nominal interest rate and effective interest rate, were assumed when determining the recommended appropriation of \$10 million? Based on these assumptions, what amount of investment earnings will be required to fully fund short-term borrowing interest costs? What percentage of total estimated investment earnings does that amount represent?

## **ANSWER 5**

No additional TRANS will be issued in FY2007. FY07 is projected to have net revenue from investment earnings whereas FY08 will require an appropriation so the cash flow for FY08 is not expected to be better than FY07. FY07 had the benefit of higher earnings due to the half penny of sales tax revenue that was collected in FY07 and not expended until FY08. The Budget Message assumes the need for \$2 billion to be issued on October 1, 2007, total interest cost of \$65.6 million, net \$56.8 million – nominal rate 4.5% and effective rate 3.9%. Investment earnings that would be required approximate \$46.8 million representing about 66%. Projections can radically change based on the final appropriations act and the timing of the property tax relief payments.

## **DISCUSSION POINT**

The FY 2008 Governor's Budget includes new language appropriating the revenue generated from the sale of Solar Renewable Energy Certificates (SREC). The revenues would fund energy-related savings initiatives as determined by the Director of the Department of the Treasury's Office of Energy Savings, and be subject to the approval of the Director of the Division of Budget and Accounting. The SREC program awards a renewable energy certificate to the owner of a solar energy system in New Jersey for each 1000kWh (1MWh) of energy generated through solar power. The certificates represent all the clean energy benefits of electricity generated from the solar electric system, and can be sold by the owners to electricity suppliers, renewable energy marketers, private businesses, individuals interested in supporting the development of solar energy, and to electric suppliers in the State that are required to invest in solar energy under New Jersey's Renewable Portfolio Standards (RPS). The program is implemented through the State's Clean Energy Program website, through an online interface that permits owners to register and provides for the creation, verification, and sale of certificates.

## **QUESTION 6**

Please describe how the State derives revenues from the sale of Solar Energy Certificates under this program. How did the State attain an interest in such certificates? Which State facilities are involved? What revenues are expected from these? Please estimate the State's revenue from sales of such certificates in the next five fiscal years. By what process will the State select purchasers of the SREC's it seeks to sell?

## **ANSWER 6**

The State has the ability to sell Solar Renewable Energy Certificates (SRECs) which it acquires through the operation of any State-owned photovoltaic (PV) systems. The Office of Energy Savings (OES), within the Department of the Treasury, will be tracking the generation of SRECs and the subsequent sale of them into the open market. Initially, this will be performed for the PV system located at the new State Police Emergency Operations Center and then for any new PV systems that are constructed at State facilities going forward, where the State has ownership rights to the SRECs.

For the Emergency Operations Center, the State expects approximately \$60,000 in annual revenue from the sale of SREC's for that PV system. Over the next five years, total SREC revenue is expected to be at least \$300,000 and possibly higher if SREC market prices rise above their current levels over that time period. The OES will be using a competitive bid process for selling the SRECs, where the highest-price bidder(s) will be selected to buy the certificates.

## **DISCUSSION POINT**

The proposed FY 2008 Governor's Budget includes language to appropriate out of the Petroleum Overcharge Reimbursement Fund (PORF) the sum of \$3.5 million to fund energy-related savings initiatives, including an Energy Tracking System (ETS) and an invoice payment system, as determined by the Director of the Department of the Treasury's Office of Energy Savings, and subject to the approval of the Director of the Division of Budget and Accounting. According to the Budget in Brief, the ETS is to determine current levels of energy performance for State facilities in order to develop a strategy for reducing energy consumption, costs to the State, and greenhouse gas emissions. Funds in the PORF, which was established by P.L.1987, c.231 (C.52:18A-209), come from moneys received by the State for overcharges for petroleum products pursuant to any agreement between the United States Government and a petroleum company.

## **QUESTION 7**

Is the \$3.5 million allocation to the ETS from the PORF from existing funds in the fund, or from an expected influx of moneys into the fund? Have all necessary federal court approvals for use of these resources been secured? Please describe the proposed Energy Tracking System in detail, including the costs and benefits, and please indicate any target dates for acquisition and implementation. Is such a system readily available commercially, or one that requires custom design according to user specifications? What role, if any, will energy providers

play in the effective deployment of the system? Please explain in detail the characteristics, costs and benefits of an invoice payment system. Does this system function in tandem with the Energy Tracking System, or are the two stand-alone projects that can be undertaken separately and sequentially? How does this program differ from the \$200,000 energy efficiency study being funded from the Clean Energy Fund transfer?

#### **ANSWER 7**

The \$3.5 million allocation from the PORF is based on existing funds. In accordance with past practice, approval will be sought from the federal Department of Energy. Securing that formal approval is not expected to be problematic.

The Energy Tracking System (ETS) will enable the State to continuously monitor and evaluate building energy consumption, cost, and greenhouse gas emissions for all enrolled facilities. Focus will be on key performance metrics such as \$ per square foot, BTU's per square foot, \$ per kilowatt-hour, tons of CO2 equivalent, etc. This will essentially provide for continuous energy audits for all enrolled facilities. There are also systems that allow for automated benchmarking using the EPA's Energy Star scoring system, to see how our facilities are performing versus similar buildings around the country. The ETS will allow for regular reporting of department energy performance and will raise department visibility and accountability to ensure continuous improvement. It will also enable the State to focus resources on facilities that present the greatest opportunities for improvement.

An ETS is typically developed by using a specialized vendor to centralize the utility bill payment process to allow for extraction and auditing of key data, but can also be arranged through other methods. The cost for a full-service approach is usually based on a fixed fee per invoice and is expected to run between \$100,000-300,000 annually for the State, based on an estimate of processing 20,000-30,000 bills each year. While the payment processing aspect can be separated out, there are certain efficiencies that can be realized by keeping these services together to streamline payment processing and reduce associated cost. However, both approaches are currently under consideration. Cost reduction and environmental benefits are expected to far exceed the expense, with a 2% reduction in energy consumption yielding a \$2.8 million benefit. The Office of Energy Savings is striving to have an ETS in place in calendar year 2007.

There is a mature market of seasoned vendors who specialize in utility bill processing and they have the ability to apply their proven systems and approaches

to deliver immediate benefits to large clients like the State of New Jersey. While some aspects of their system would be custom-developed for our needs, they have significant economies of scale and are already processing invoices for other clients within the State, which would minimize the development process and associated expense.

The \$200,000 being budgeted for energy efficiency studies is a separate initiative for performing comprehensive building energy audits at high-potential State facilities, to identify and rank potential energy conservation measures.

## **DISCUSSION POINT**

The FY 2008 Governor's Budget proposes new expenditures of \$10 million dollars for Energy Efficiency, Statewide Projects. According to budget language, this amount is payable from the Clean Energy Fund to provide the full cost of energy efficiency projects in State facilities, including, but not limited to, \$6 million for heating, ventilation and air conditioning systems at various Human Services institutions, \$2.8 million for pneumatic systems at State-owned office buildings in Trenton, \$925,000 for heating, ventilation, and air conditioning systems at the Military and Veteran's Affairs Paramus Veterans home and at State-owned facilities in Trenton, and \$200,000 for an energy efficiency study of State-owned facilities.

## **QUESTION 8**

How were the projects listed in the budget language prioritized? What criteria was used? What are current energy costs and what are the projected savings in energy costs? When will expected energy cost savings be realized and what are the time lines for these savings? How will the appropriation for the energy efficiency study be expended? Who will conduct the study and what is its purpose? What is the expected start and completion date for the study?

## **ANSWER 8**

Each of the projects listed in the budget language proposed in the FY2008 Governor's Budget Message was included in capital requests submitted by various departments to the Commission on Capital Budgeting and Planning for the fiscal 2008 budget cycle. The Commission recommended funding for each project, and the Governor's Budget Message added the budget language that charges those costs to the Clean Energy Fund.

State departments requested a total of nearly \$90 million in energy-related investments in fiscal 2008, and many of these projects have been awaiting funding for several years. Typically, the projects listed represent the respective departments' highest priority, energy efficiency initiative. For example, Human Services' \$37.4 million request for HVAC improvements in eleven institutions for developmentally disabled and mental health patients represents that department's third-highest capital priority. Most of the remaining requests were identified by the Department of Treasury's Division of Property Management and Construction (DPMC) and were listed among the top priorities for Interdepartmental capital funding.

In addition to the department's ranking of the project, the selection criteria took into account the critical nature of the facilities involved, the age of the existing equipment, the potential for energy savings, and the impact on clients (e.g., Human Services institutions). The language proposed for the FY2008 Budget was crafted to provide a key role for the Department of Treasury's new Director of Energy Savings, both in estimating the potential energy savings, validating the value of each project and adjusting their scope, and determining the proper allocation of funds. That analysis will ensue during fiscal 2008, in concert with the Office of Management and Budget.

The \$200,000 set aside for the Energy Efficiency Study will be used by DPMC to perform energy audits on State facilities in Trenton. Those audits will be carried out during FY2008. Historically, such audits have realized savings of approximately 15% of the utility costs in each facility. It is expected that the energy savings from these audits will quickly offset the cost of the study once the suggested improvements are implemented.

## **DISCUSSION POINT**

According to the Liberty Science Center, which has been open since 1993, nearly nine million people have been served, making it the most visited museum in New Jersey and one of the most widely used in the country. It is currently being renovated and expected to re-open July 2007. The FY 2008 Governor's Budget proposes an increase of \$6.9 million dollars in State funding to pay debt service through the Economic Development Authority.

## **QUESTION 9**

Will the projected re-opening date of July 2007 be met? If not, what is the projected re-opening date and the reason for the delay? What is the current status of the project? Please provide an itemized breakdown of any State costs

anticipated for the future to support the new facility beyond debt service. Prior to the expansion, what was the total number of exhibits, films, programs, etc. offered and what is the projected increase in these items after the re-opening? How many people visited the Liberty Science Center within the past 5 years and by what percentage do you expect that number to increase?

#### **ANSWER 9**

The center is scheduled to reopen to the public July 19, 2007. Skanska USA is finalizing the building construction. Exhibits are currently being installed in the building. The TCO is expected on June 26. Liberty Science Center's annual gala is set to be June 28 in the building.

Liberty Science Center has received \$6.0 million in FY00, \$6.6 million in FY01-FY03, \$6.1 million FY04-FY06, \$3 million for FY07 and \$3 million is proposed for FY08 from the State for science education services provided to the Abbot Districts. These services include field trips to the science center, teacher training, distance learning services, traveling science demonstrations, community evenings at the Science Center and Family Science days in the Abbott cities and towns, and a free family pass valid for the full year for each student in the Abbott schools. Liberty Science Center anticipates continuation of this partnership with the State after we reopen.

The number of exhibits varies depending on what is being shown at any particular time. The Center will still have the IMAX Theater, which will reopen showing 3 films, and the JD Williams Theater, which we anticipate will be showing a new 3-D high definition film. There is one new theater which is for educational programs and which will be the home of the "Live From" program which will show live open heart surgery from Morristown Hospital, live neurosurgery from Overlook Hospital and live kidney transplant surgery from St. Barnabas Hospital. There is also a brand new Center for science Learning and Teaching which will have 6 lab spaces including a young learners room, 3 wet labs and 2 dry classroom type spaces, along with a teacher resource center and a large open center area to house major programs such as the Panasonic Challenge or first robotics competition.

The space allocation are as follows, in sq.ft.:

	<u>Original</u>	<u>New</u>
<b>Exhibition/Education space</b>		
Environment floor	15,522	
Health floor	12,176	
Invention floor	15,326	
Traveling exhibit space	7,342	7,500
Skyscraper! Achievement and Impact		12,500
Our Hudson Home		8,500
Infection Connection		7,500
Communication		7,500
Eat and Be Eaten		6,100
Wonder Park		4,800
E-Quest, Exploring Earth's Energy		3,300
I Explore (Young Learner Gallery)		3,000
Breakthroughs (Current science in the news)		3,000
Center for Science Learning & teaching	852	19,000
Theaters	21,198	24,200
<b>Other space</b>		
Tower	3,280	5,700
Arrival/box office/first aid/queuing areas	9,765	23,650
Food Service	8,542	13,500
Retail	4,285	7,000
Staff Offices/back of house	23,864	45,600
Circulation/core/atrium	73,941	93,720
<b>Total</b>	<u>196,093</u>	<u>296,070</u>

Attendance for the past 5 years that Liberty Science Center was open was:

	<u>FY01- FY05</u>	<u>Average</u>	<u>Reopening plan</u>	<u>Increase</u>
Daily paid attendance	2,580,000	516,000	1,044,000	102%
Other onsite programs	160,500	32,100	50,000	56%
Camp-ins, teacher workshops, etc.				
Abbott Partnership Program onsite only	335,500	67,100	124,000	85%
Offsite- traveling science, teacher workshops	975,000	195,000	200,000	3%
On-line - distance learning	44,000	8,800	18,000	105%
<b>Total</b>	<u>4,095,000</u>	<u>819,000</u>	<u>1,436,000</u>	<u>75%</u>

## **DISCUSSION POINT**

The FY 2008 budget includes as categories of Property Rentals payments to the New Jersey Economic Development Authority (EDA) for the state's lease-purchase of facilities acquired or built by the EDA (\$17.1 million) and other payments for debt service leases and payments in lieu of taxes on facilities occupied by State agencies (\$23.6 million). While leasing costs for State use of privately owned facilities are presumably market-driven and provide an owner a profit, lease payments to the EDA are calculated based on EDA administrative costs, debt service payments on EDA bonds issued to acquire or build the facility, and payments in lieu of tax obligations that have been negotiated with municipal officials.

The EDA recently sold \$18.25 million of taxable bonds for the Lafayette Yard Hotel Project. The bonds relate to the refunding of bonds previously issued by the Lafayette Yard Community Development Corporation, a private non-profit agency, to build the Lafayette Yard Hotel/Conference Center in Trenton. It appears that the key revenue stream dedicated to repayment of bonds consists of payments in lieu of taxes payable by the EDA to the City with respect to Capital Place One, an EDA-owned office building adjacent to the hotel occupied by the Department of Human Services. The State and the EDA have negotiated an agreement for "Supplemental Rent" to be paid by the State to the EDA for use of Capital Place One, in amounts sufficient to pay debt service on the Hotel Project bonds. These payments will range from \$1.5 million to \$2.7 million annually over the 13 year life of the bonds and will total \$26.7 million.

## **QUESTION 10**

Please explain in detail the financing arrangement the State has entered into with the EDA in support of the Lafayette Yard Hotel/Conference Center project and the reasons for entering into this arrangement. Does the arrangement give the State any present or future ownership, use or other rights with respect to the hotel/conference center? If not, why is this financing arrangement preferable to one in which the State acquires such rights? What were the EDA's payments in lieu of taxes to the city with respect to Capital Place One prior to this agreement, both in dollar amount and as a percentage of full taxes otherwise due if the property were taxable? What will those payments be, in amount and as a percentage of full taxes, under this agreement? Please provide a list of all other State-leased facilities where payments in lieu of taxes are part of rent payments, listing the lessor, the municipality where the project is located, the year when lease commenced, the amount of the annual payment for FY 2004-FY 2008 inclusive, and the percentage of full taxes each annual payment comprised. Does the

Lafayette Yard arrangements set a precedent that could lead to the State committing substantial resources to the economic viability of private ventures?

#### **ANSWER 10**

The New Jersey Economic Development Authority (NJEDA) issued \$18,250,000 Economic Development bonds, Series 2007 (Lafayette Yard Hotel Project) on March 29, 2007. The NJEDA bond proceeds were used to purchase the City of Trenton \$18,250,000 Redevelopment Revenue Bond, Series 2007 (the "City Bond"). The proceeds received by the City were used to: (i) defease a portion of the outstanding Lafayette Yard Community Development Corporation, Hotel/Conference Center Project Revenue Bonds, Refunding Series 2001 (City of Trenton guaranteed); (ii) pay interest on the remaining Lafayette Yard Community Development Corporation bonds for April 1, 2007, October 1, 2007 and April 1, 2008; (iii) pay costs of defeasing the outstanding bonds; and (iv) pay costs associated with the issuance of the City Bond and the NJEDA Bonds.

The City Bond is secured solely by the payments in lieu of tax (the "Pilot") made by the NJ EDA to the City of Trenton, relating to Capital Place One, under the Payment in Lieu of Taxes Agreement (Pilot Agreement) entered into by NJEDA and City of Trenton on March 30, 2005. No revenues of the City, other than the Pilot, are pledged to repayment of the City Bond. NJEDA leases Capital Place One to the State of New Jersey, under an Agreement of Lease dated January 1, 2000 and further supplemented on March 30<sup>th</sup> 2005. The supplement to the Agreement of Lease provides for the State to pay to the NJEDA as Supplemental Rent a payment in lieu of taxes, subject to annual appropriation. This Supplemental Rent is the source of repayment for the City Bond. The City has assigned its right to receive the Supplemental Rent to the bond trustee, Wells Fargo Bank, N.A, who then uses these receipts to make payment to bondholders of NJEDA bonds secured by the City Bond.

No, the State does not have any present or future ownership of the hotel/conference center. The various lenders to LYCDC are the only ones who have security interest in the hotel property.

The City of Trenton made the determination to use the pilot payment to secure the City bond. The State's payment of the Pilot is related to the lease for Capital Place One not the hotel/conference center.

The PILOT agreement was initially entered into by the city of Trenton and the NJEDA on March 30<sup>th</sup>, 2005. In the PILOT agreement, NJEDA agreed to pay an annual PILOT payment beginning in FY 05 of \$1.3mm, compounded thereafter

by 5% per annum. An amendment to the Agreement and Lease (Capital Place One Office Building Project) between NJEDA and the State of New Jersey (originally entered into as of January 1, 2000), was amended on March 30<sup>th</sup>, 2005 to provide for the payment of Supplemental Rent, subject to annual appropriation, in order to pay a PILOT payment beginning in FY05, in an amount not to exceed \$1.3mm compounded by 5% annually for each State Fiscal Year during the Lease Term.

PILOT payments have been made as follows:

FY05	\$1,300,000
FY06	\$1,365,000
FY07	\$1,433,250

Although NJEDA purchased Capital Place One in 1998, no PILOT payments were made prior to FY05. Were the property privately owned, NJEDA estimates that annual property taxes (at full taxation) would amount to approximately \$672,269.

PILOT payments, as noted in previous answer, are calculated as follows: \$1.3mm in FY05, compounded by 5% annually for each state fiscal year during the lease term. Those amounts are:

<u>Fiscal year ending June 30</u>	
2008	\$1,504,913
2009	1,580,158
2010	1,659,166
2011	1,742,124
2012	1,829,231
2013	1,920,692
2014	2,016,727
2015	2,117,563
2016	2,223,441
2017	2,334,613
2018	2,451,344
2019	2,573,911
2020	2,702,607

We do not believe this sets a precedent. Prior to 2005, the NJEDA, the State and the City of Trenton had not reached agreement on a Pilot payment. The City determined to use the PILOT payments as security for its City Bond and used the proceeds of its sale to reduce the City's guaranty obligations with respect to the Lafayette Yard Community Development Corporation, Hotel/Conference Center Project Revenue Bonds, Refunding Series 2001 (City of Trenton guaranteed).

Attachment A lists the other current State PILOT payments.

We are continuing to research whether there are any other instances where the State has agreed to pay “supplemental rent” for the use of one facility explicitly to provide financial support to another facility.

ATTACHMENT A

Building Name	Street Address	Municipality	County	Pilot Agreement Commencement Date	Annual Payment				
					FY 04	FY 05	FY 06	FY 07	FY 08 Anticipated
Camden State Office Building	101 Haddon Ave, Camden	Camden City	Camden	Jul-07	\$310,000.00	\$316,200.00	\$321,300.00	\$327,726.00	\$334,280.00
Asbury Park State Office Building	630 Bangs Avenue, Asbury Park	Asbury Park City	Monmouth	Jan-00	\$62,812.91	\$64,069.17	\$65,350.55	\$66,657.56	\$67,990.00
Cherry Hill DOT Building	One Executive Campus, Route 70, Cherry Hill	Cherry Hill Twp.	Camden	Dec-02	\$90,780.00	\$92,595.60	\$94,447.52	\$96,336.46	\$98,263.00
Justice Complex	Market & Warren St.	Trenton City	Mercer	Jan-78	\$5,367,214.60	\$5,460,557.48	\$5,507,228.92	\$5,623,907.48	\$5,736,385.00
Trenton Office Complex	225 E. State St SE Corner & Montgomery Street	Trenton City	Mercer	Jun-90	\$4,064,775.80	\$4,135,467.56	\$4,170,813.44	\$4,259,178.12	\$4,344,361.00
DHS Cap Place One Building	222 S. Warren St., Trenton	Trenton City	Mercer	Mar-07	\$0.00	\$1,300,000.00	\$1,365,000.00	\$1,433,250.00	\$1,504,912.00