



Addressing the Needs of Public Buildings through Tax Reform

Submitted by the Performance Based Building Coalition

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April 15, 2013

Chairman David Camp
Ranking Member Sander Levin
1100 Longworth House Office Buildings
Washington, D.C. 20515

Dear Chairman Camp and Ranking Member Levin,

On behalf of the Performance Based Building Coalition (PBBC), we would like to submit the attached white paper to the Debt, Equity, and Capital; Financial Services; Real Estate and Education and Family Benefits tax reform working groups. The PBBC is a recently formed coalition that includes over thirty members representing infrastructure funds, contractors, engineering/architecture firms, public officials, associations, and others (see enclosed list). The PBBC's mission is to facilitate the use of private investment in the construction, renovation, and replacement of our nation's aging and dilapidated public buildings, which includes, among other things, schools, courthouses, city halls, civic centers, and correctional facilities.

The PBBC believes that public-private partnerships (PPPs) are an innovative and cost effective solution for cities and localities to replace and renovate U.S. public buildings. As the Committee considers options for tax reform, our white paper is intended to illustrate how reforms to the tax code can help to address the problems facing our schools, courthouses, city halls and other public buildings.

The PBBC looks forward to being a resource to the Ways and Means Committee. We are eager to engage on this issue and could be available for meetings, hearings, and other opportunities to illuminate the need for Congress to use the tax reform process to unlock the doors to PPPs for public building projects.

Sincerely,

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Overview

Our nation's public buildings – which include schools, hospitals, courthouses, universities, police stations, prisons – are in a historic state of disrepair.

State and local communities struggle to address mounting infrastructure needs:

- Over 14 million children attend deteriorating public schools that are in need of maintenance and repair projects worth \$270 - \$500 billion.¹
- Since the start of the recession, 67% of hospitals have put on hold desperately needed capital projects.²
- 42 states have significant shortfalls in infrastructure funding for courthouses, which have resulted in facilities that often do not comply with current codes, disability requirements, and often have inadequate security.³

The enormity of this public building infrastructure backlog cannot be adequately addressed through traditional public financing and project delivery options. Instead, the severity of infrastructure need at the state and local level demands an innovative solution to fast track repair and replacement of public buildings and to provide infrastructure more efficiently.

Solution: Catalyze the use of Public-Private Partnerships (PPPs) for schools, hospitals, courthouses, and other government owned facilities by creating a new category of Private Activity Bonds (PABs) for public buildings.

Traditional Project Delivery: Inadequate to Meet Needs

Traditional approaches to project delivery, such as design-bid-build (DBB), often lack the capital needed to finance major infrastructure projects. Without sufficient capital, infrastructure projects experience delays that increase their cost. In a survey conducted by the National League of Cities in 2011, 57 percent of city finance officers reported that their cities were less able to meet their fiscal needs in 2011 than in the previous year. The survey also revealed that

¹ News Release, "Crumbling schools don't provide strong foundations for America's students," *National Education Association* (December 9, 2011).

² AHA analysis of Telling the Hospital Story survey data from 572 non-federal, short-term acute care hospitals collected in March and April 2010.

³ Wm. T. (Bill) Robinson III, "Future Trends in State Courts," *National Center for State Courts* (2012).

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60 percent of cities said they delayed or canceled capital projects that year due to fiscal conditions.⁴

With the traditional DBB approach to project delivery, two different contracting efforts must be undertaken in sequence to procure architecture/engineering services on a negotiated-price basis and construction services on a lowest-responsible-bid price basis. While a design-bid-build delivery model generally provides the lowest first-cost, it usually does not consider the 'whole life cost' of a building, leaving the owners with increased risk of operations. Typical government budgets do not allow for the quality maintenance to be performed that is necessary to ensure performance and maximize the expected life of equipment. This reality has shown to be more costly over the life of a building with a DBB approach than in instances where projects are delivered using a public-private partnership (PPP).

In addition, because design and construction are not integrated in a DBB method, it can take more time for the project to be completed from start to finish. Each phase in a DBB is implemented separately and cannot start until the previous phase has been completed; unlike a PPP approach where the phases are integrated, ensuring accelerated delivery. A DBB approach can also lead to greater risk for a public owner since contracts between the designer and general contractor are separated, placing liability on the owner when things go wrong. Further, in a DBB the public owner is also forced serve as a mediator for any design and construction issues for each party, which can lead to significant delays and conflict.

The University of Arizona undertook a study in 2012 which compared DBB, design-build (DB), and a PPP approach in North American highway construction projects. The study revealed that the PPP sample cost overruns and schedule delays were significantly less than both DB and DBB delivery methods. *The PPP projects averaged 0.81% for cost overruns and -0.30% for schedule delays, compared with 1.49% cost overruns and 11.04% schedule overruns for DB projects and 12.71% cost overruns and 4.34% schedule overruns for publicly financed large-scale DBB highway projects*⁵.

Given the magnitude of the need and constrained budgets, cities, states and the federal government lack the resources, tax base, and time to utilize a traditional construction (DBB or DB) approach to replace and restore public buildings.

⁴Christopher W. Hoene & Michael A. Pagano, "Research Brief on America's Cities," *National League of Cities* (September 2011).

⁵Ankit Bansal, Allan D. Chasey, William E. Maddex, "A Comparison of P3's, DB and DBB Project Delivery Methods in North American Highway Construction," 10th Latin American and Caribbean Conference for Engineering and Technology (July 23-27, 2012).

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The Path Forward: Public-Private Partnerships for Public Buildings

A PPP is defined by the National Council for Public-Private Partnerships as:

“A contractual agreement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares the risks and rewards potential in the delivery of the service and/or facility.”⁶

PPPs provide an alternative to traditional project delivery options. There are several different types of PPP arrangements. In a performance based PPP, a private partner designs, constructs (or refurbishes), finances and provides facilities management services to a state or locality under a long-term contract. Typically, these contracts span 25-35 years.

Benefits of a PPP Approach:

- Provides an integrated form of delivery, which is undertaken through a design-build-finance-maintain (and/or operate) approach, with a single point of accountability.
- The public sector retains asset control through binding specification of performance requirements and standards.
- A PPP contract provides integration of all the activities by a single private entity, which results in greater life-cycle savings and higher performance standards than in traditional public procurements, where the activities are distinctly managed by different parties.
- The public and private sector share the risks and rewards of delivery, enabling them to complete projects faster, within budget, and at enhanced value for taxpayers.
- Contract mechanisms ensure long-term standards are achieved, including financial and specific performance penalties.

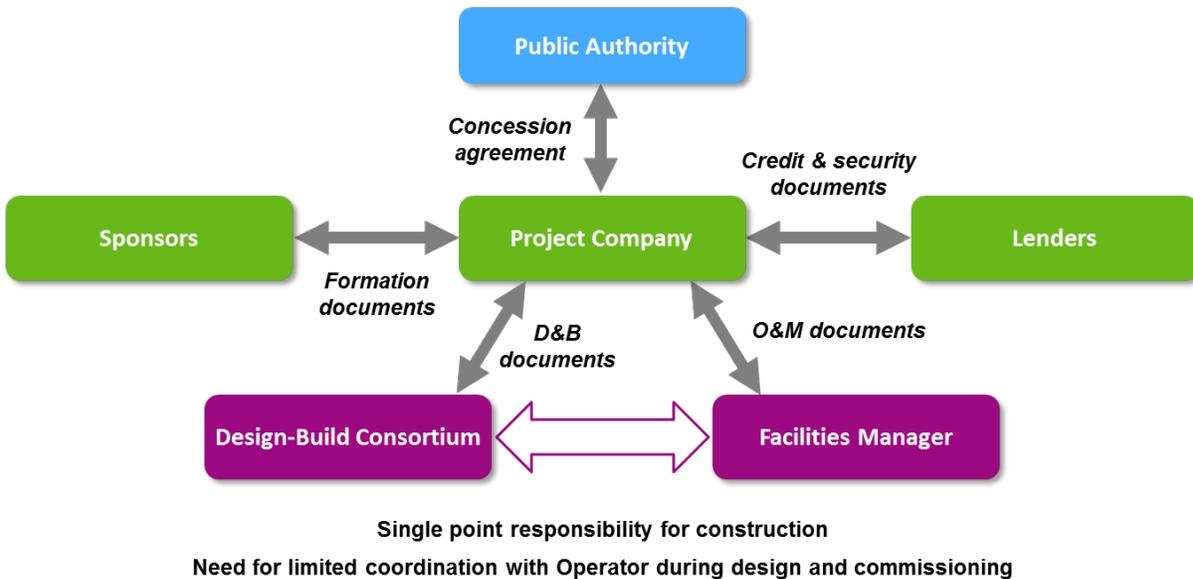
The image below depicts the typical contractual structure of a performance based PPP. As shown, the Public Authority enters into a long-term contract, or project agreement, with a private sector Project Company. Through this arrangement, the private sector assumes many risks typically retained by the public entity, such as overseeing the design and the construction, along with the long-term facilities maintenance and operations. Consequently, the

⁶ National Council for Public-Private Partnerships 2012 white paper, *Testing Tradition: Assessing the Added Value of Public-Private Partnerships*.

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government no longer has to serve as a referee between a designer and contractor – that is now the job of the Project Company. The line between the design-build consortium and the facilities manager denotes the necessary coordination between the two groups. The long-term operator is incentivized to ensure the design-build consortium is taking into account a life cycle approach to design and construction which provides maximum efficiency.



PPPs: A Jobs Catalyst

One of the major benefits of a PPP approach is the ability to deliver infrastructure projects much faster and more efficiently than through other procurement methods. The sooner projects are delivered, the sooner jobs are realized. For this reason, PPPs have often been referred to as a budget multiplier – one that uses an efficient allocation of risk to stretch tax dollars, create jobs, and do more with less.

The U.S. Infrastructural Report,⁷ published in 2010, suggested that PPPs are the only way to ensure that infrastructural provision in the U.S. does not become an economic liability. In Maryland, Lieutenant Governor Anthony Brown recently noted that, on an annual basis, PPPs

⁷ United States Infrastructure Report Q2 2010, *Business Monitor International*.

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could pay for up to \$315 million in projects, create as many as 4,000 jobs, and contribute between 6 and 10 percent of the State's capital budget.⁸

According to Professor Stephen Fuller, Dwight Schar Faculty Chair and University Professor and Director, Center for Regional Analysis at George Mason University, every \$1 billion in nonresidential construction spending adds about \$3.4 billion to U.S. GDP, about \$1.1 billion to personal earnings and creates or sustains 28,500 jobs.⁹ Considering just the tremendous backlog of school infrastructure needs, PPPs can help accelerate the modernization of these facilities, creating 9,000-10,000 jobs per billion dollars spent.¹⁰ According to the Economic Policy Institute, eliminating just half the backlog in school repairs and improvements would, over a period of years, create more than 2 million jobs while improving the buildings in which our students prepare for the future.¹¹

PPPs: At Work

International Success

Although PPPs are relatively new to the U.S., they are quite common across sectors internationally. For instance, Canada has used PPPs to deliver over 100 projects since the early 1990s,¹² and from 2009-2011 alone had 23 healthcare, 12 transportation, 11 justice, 4 recreation, and 2 education projects in procurement.¹³ Australia has completed 127 PPP projects since their first project reached finance close in 1987, including 27 transportation, 23 healthcare, 19 water, 18 justice, 15 recreation, and 13 education projects.¹⁴ Furthermore, across the United Kingdom there are 39 PPP projects currently under procurement and another 717 contracts already underway in defense, environmental protection, government buildings, hospitals, information technology, municipal services, prisons, recreation, schools, solid waste, transport, tourism, and water.¹⁵

⁸ Candy Thomson, "State leaders hope legislation will spur public-works projects, jobs," *The Baltimore Sun* (January 18, 2013).

⁹ Testimony of Stephen Fuller to the U.S. House of Representatives Committee on Transportation and Infrastructure (January 22, 2009).

¹⁰ Mary Filardo, Jared Bernstein, and Ross Eisenbrey, "Creating Jobs Through FAST!, a Proposed New Infrastructure Program to Repair America's Public Schools," *21st Century School Fund, Economic Policy Institute* (August 11, 2011).

¹¹ *Ibid.*

¹² "Dispelling the Myths, A Pan-Canadian Assessment of Public-Private Partnerships for Infrastructure Investment," *Conference Board of Canada* (January 2010).

¹³ "The Benefits of P3s," *PPP Canada* (2012).

¹⁴ "Australia's Public Private Partnerships pipeline," Infrastructure Australia, http://www.infrastructureaustralia.gov.au/public_private/(2013).

¹⁵ "UK Private Finance Initiative Projects: Summary data as at March 2012," HM Treasury.

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U.S. Transportation Projects

Over the past 10 years, the U.S. has undertaken 15 PPP transportation projects worth over \$22 billion that have resulted in significant cost savings to states and localities. One of these projects, the Denver FasTracks Eagle light rail expansion project, undertaken through a PPP approach, is being delivered \$300 million less than if constructed through a traditional design-bid-build method¹⁶ and is expected to be completed 11 months ahead of schedule.¹⁷ Another project, the Florida I-595 highway project will provide capacity improvements at least 15 years sooner than if delivered through a conventional plan. The I-595 project has created 2,039 jobs and sustained the employment of 139 companies.¹⁸ Finally, the Port of Miami Tunnel (POMT) project, is demonstrating how a PPP can enable a project to move forward that would otherwise be on the drawing books for years. The PPP bid price for the POMT was almost 50% less than the Florida DOT's own internal estimate.¹⁹

Long Beach Courthouse

One of the best examples of the true value of PPPs is the Long Beach Courthouse. In 2010, California advanced the Long Beach Courthouse as the first ever U.S. public building PPP, which will be completed 30 months sooner than a project done by traditional procurement. The \$490 million project was awarded to a private consortium, which included Infrastructure Developers/Investors, Designers and Engineers, a Design-Builder and a Facilities Management Provider. The consortium will be responsible for the design, building, operation and maintenance of a new 545,000-sq. ft. courthouse to replace its dilapidated courthouse, which was built in 1959.

To finance the initial development costs, design and construction, the consortium put in place a project-financing package consisting of long-term equity (10%) and debt (90%), with a total investment of just under \$500 million. The Lead Developer paid \$49 million in cash equity at the closing. In exchange for these services, the consortium will be paid an annual service fee by the State Judicial Administrative Office of the Courts with such payments starting only upon completion of construction. The service fee was contractually fixed at the time of the closing and has a mortgage-like payment profile over the 35-year operations period, plus an inflation indexation. The service fee payments are linked to specific availability and performance milestones, which involve specified response times and potential payment deductions if requirements are not met. The most important milestone is the availability of fully functioning courtrooms for their intended use each day of the year. There also is a range of other

¹⁶ "Eagle P3 Project Procurement Lessons Learned," *RTD FasTracks* (August 31, 2011).

¹⁷ Jeffrey Wolf, "RTD to add 3,000 jobs for DIA rail line," *9news.com* (June 28, 2010).

¹⁸ "I-595 March 2013 Project Overview," *I-595.com* (February 1, 2013).

¹⁹ Barney A. Allison, "A Look At 2009 Major US P3 Transactions," *infrainsightblog.com* (February 1, 2010).

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maintenance and operational performance indicators, which if not met, may trigger deductions in the service fee payments.

This arrangement gives the private sector a great incentive to design the project to operate with optimal efficiency and reliability, complete the construction of the project on time and on budget (so that the service fee payments start as scheduled) and then to operate and maintain the project in such a condition to avoid potential deductions in payment.

Leveling the Playing Field for PPPs: Private Activity Bonds

The reason why PPPs have been so popular internationally is because countries like Australia and Canada recognized very early, that their economies can only grow, if they provide the necessary infrastructure and if they provide it in the most efficient and sustainable way possible. These nations took consequent measures which ensured that the use of PPPs is encouraged and that PPPs are seen as part of the modern tool box of providing public infrastructure. The national governments identified legislative and commercial hurdles which would prevent public agencies from using PPPs and introduced laws and procedures which would overcome these challenges.

U.S. states and cities are realizing that given constrained budgets and growing infrastructure needs, PPPs must be utilized to deliver projects with greater innovation and long-term performance. As a result, more than 35 States have passed legislation authorizing a PPP delivery approach and five more are currently considering following suit. But, authorizing legislation in States is only one step to opening the U.S. market to PPPs. As we saw through the transportation and solid waste sectors, federal action to remove federal obstacles is also critical.

The expanded use of transportation PPPs in the U.S. is attributable to the passage of the Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) in 2005, which added highway and freight transfer facilities to the types of privately developed and operated projects for which certain qualified private activity bonds may be issued.

Prior to the creation of transportation exempt facility bonds, public owners considering a PPP resisted undertaking this new approach because the financing would be 100% private, whereas a traditional method of delivery could utilize 100% tax-exempt financing, which is much cheaper. Despite the value for money advantages of a PPP (cost and schedule certainty, along with long-term risk transfer and life cycle cost benefits), most public officials chose a traditionally tax-exempt financed approach for fear of press backlash due to lack of understanding that a project can have higher financing costs while still deliver much greater value and long-term savings over the long-term.

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By authorizing qualified private activity bonds for transportation projects, SAFETEA-LU negated the cost of capital issue and aligned the incentives of states to undertake an innovative PPP approach for all public transportation projects. This new category of transportation exempt facility bonds has allowed public transportation projects to combine tax exempt financing with private financing, thereby lowering the overall cost of financing for PPP projects. This category of exempt facility bonds is intended to make the interest on bonds in respect of certain private infrastructure projects eligible for the same exclusion from the calculation of gross income for Federal income tax purposes that interest on bonds issued by state and local governments enjoy.

- ***Since 2001, exempt facility bonds have facilitated more than \$10 billion in innovative transportation projects in the country.***

Given the success of PPPs in the U.S. transportation sector and in delivering public buildings globally, PPPs should be considered as a new way to improve our schools, correctional facilities, hospitals, labs, and courthouses. The utilization of PPPs for public buildings has been limited because unlike the transportation, solid waste, or water sectors, public buildings are not eligible for exempt facility bonds. This inhibits public building PPPs from combining tax exempt financing with private financing, resulting in an increased cost of financing. As a result, state and local governments are apprehensive to use a PPP approach for public building infrastructure despite the significant value for money, accelerated delivery, and risk transfer benefits of a PPP.

The Ways and Means Committee, as part of its tax reform legislation, should open the U.S. market to public building PPPs by creating a new category of exempt facility bonds that allows private investment to be combined with tax-exempt financing to design, build, finance, and maintain our public buildings.

For further information, please contact:

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1. AECOM
2. Allen & Overy
3. American Council of Engineering Companies
4. ASHRAE
5. Associated General Contractors NYS
6. Associated General Contractors of America
7. Clark
8. Component Assembly
9. Construction Risk Partners
10. Cristal Controls
11. Edgemoor Infrastructure & Real Estate
12. Faithful + Gould
13. Farella Braun + Martel LLP
14. Fulbright & Jaworski
15. Gilbane Inc.
16. Hawkins Delafield & Wood LLP
17. Hochtief
18. Honeywell
19. HUNT
20. Johnson Controls Inc.
21. Kiewit Building Group, Inc.
22. LPCiminelli Solutions
23. Malachite LLC
24. Meridiam
25. Nossaman
26. Pace Engineers
27. Parsons Brinckerhoff
28. Peckar & Abramson, P.C.
29. Skanska ID
30. The Walsh Group
31. Tishman
32. Turner
33. Walbridge
34. William, Blair & Company