Committee on Transportation and Infrastructure
U.S. House of Representatives
Washington, DC 20515

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July 23, 2013

BACKGROUND MEMO

TO:	Members, Subcommittee on Economic Development, Public Buildings and Emergency Management
FROM:	Staff, Subcommittee on Economic Development, Public Buildings and Emergency Management
RE:	Roundtable Policy Discussion on "Benefits and Challenges of Public-Private Partnerships in Federal Real Estate"

PURPOSE

On Tuesday, July 23, 2013, at 11:00 a.m., in 2253 Rayburn House Office Building, Members of the Subcommittee on Economic Development, Public Buildings, and Emergency Management will participate in a roundtable discussion on the "Benefits and Challenges of Public-Private Partnerships in Federal Real Estate." The purpose of the roundtable is to explore how Public-Private Partnerships (P3s) could be used to meet the real estate needs of federal agencies. During the roundtable the Subcommittee will receive information on case studies of P3s from the private sector and conduct a discussion with the General Services Administration (GSA) and members of the private sector on the benefits and challenges of P3s.

BACKGROUND

While P3s have been used for several decades internationally and with federal transportation projects, they have been less common with federal building projects. Yet federal real estate suffers from many of the same chronic problems associated with other public infrastructure. These problems include an aging portfolio, chronic underfunding of maintenance and capital renewal budgets, excess and underutilized properties, high construction costs, and a shortage of federal appropriations. The roundtable will focus on how P3s can potentially be utilized in the federal real estate arena to help address these problems.

Problems Defined

The management of federal real estate has been labeled as a "high risk" area by the Government Accountability Office (GAO) since 2003. The basis of this determination is due to a variety of factors, including the amount of excess and underutilized properties, deteriorating and aging facilities, and the use of successive operating leases for long-term space needs that can be more costly than options that lead to ownership.[1]

As a result, GSA now leases more space than it owns. GSA's inventory includes more than 375 million rentable square feet of space, including 194 million square feet in leased space and 181 million in owned. The rental payments of tenant federal agencies in GSA's owned space fund the Federal Buildings Fund, which in turn provides the capital needed to manage, maintain, and acquire new space. The shift to more leased space without an ownership interest results in less funds available for reinvestment in GSA's owned inventory.

Compounding this problem has been the decrease in appropriated funds for new construction, acquisition, and renovation of owned properties. While in the past funds have been routinely appropriated out of the Federal Buildings Fund for large construction projects and acquisitions, little to no funds have been appropriated in recent years. Yet federal space needs continue, and there is a growing need to provide more efficient and less costly office space.

Public-Private Partnerships

Greater use of P3s in federal real estate could be an additional tool for addressing many of these problems. A Public-Private Partnership is a contract between a public sector authority and a private party, who assumes financial, technical, and operational risk in the project. The use of P3s potentially allows capital to be generated to build new infrastructure, as needed, when public agencies are unable to raise sufficient public funds up front. The public sector retains ownership and control over the project and its outcomes. A few benefits of P3's are reduction of risks and public capital investment.

GSA currently has a number of statutory authorities that could be used to enter into P3s, including the ability to enter into leases, ground leases, exchanges, out-leases, and lease-leaseback arrangements.[2]

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[1] According to the GAO, there are more than 45,000 underutilized federal properties, costing the taxpayer more than $1.7 billion annually to operate. In addition, the average age of GSA's owned real estate inventory is more than 46 years, with more than 31 percent of GSA's owned inventory built before 1949. Very often these aging facilities drive increasing maintenance costs and were not built to accommodate efficient utilization for modern office space.

[2] These authorities, largely contained in title 40 of the United States Code, include the authority to construct, acquire, lease, and exchange properties. In addition, Congress provided GSA with additional authorities specifically intended to encourage P3s. For example, section 412 of the FY 2005 Consolidated Appropriations Act (commonly referred to as "412 authority"), allows GSA to retain proceeds through sale, lease, exchange, or leaseback arrangements. GSA also has authority under Section 585 of title 40 of the United States Code, to enter into 30 year ground leases with a private entity such as a developer and authorities both under the Historic Preservation Act and the Cooperative Use Act to out-lease all or a portion of a federal building.

Types of P3s

Design-build

Design-build (DB) combines two, usually separate, services into a single contract. With design-build procurements, the government agency "owner" executes a single, fixed fee contract for both architectural services and construction. The design-build entity may be a single firm, a consortium, joint venture or other organization assembled for a particular project. Under this model, the design-builder assumes responsibility for the majority of the design work and all construction activities, together with the risks associated with providing these services for a fixed fee. Owners usually retain responsibility for financing, operating and maintaining the project and, therefore, still requires upfront construction costs that may be prohibitive in the current appropriations environment.

Design-Build-Operate-Maintain (DBOM)

This model combines the design and construction responsibilities of design-build procurements with operations and maintenance. These project components are procured from the private sector in a single contract with financing secured by the public sector. This project delivery approach is also known by a number of different names, including "turnkey" procurement and build-operate-transfer. A private entity is responsible for design and construction as well as long-term operation and maintenance services. The public sector secures the project's financing and retains the operating revenue risk and any surplus operating revenue. The design-builder-maintainer (private) assumes risk for the design and build as well as the operation and maintenance, but the public sector agency is still responsible for upfront costs of project.

Design-Build-Finance (DBF)

In this model, one contract is awarded for the design, construction, and full or partial financing of a facility. Responsibility for the long-term maintenance and operation of the facility remains with the government agency. This approach takes advantage of the efficiencies of the design-build (DB) approach and also allows the project sponsor to completely or partially defer financing during the construction phase of the project. Since the financing is done by the private entity, upfront costs to the owner are minimized. However, owners are still responsible for the operation and maintenance costs.

Design-Build-Finance-Operate-Maintain (DBFOM)

With this model, the responsibilities for designing, building, financing and operating are bundled together and transferred to private sector partners. There is a great deal of variety in DBFOM arrangements in the United States, and especially the degree to which financial responsibilities are actually transferred to the private sector. Financing is done by the private entity, and the private entity assumes operation and maintenance responsibilities. Requirements and responsibilities must be identified up front to ensure maximum benefit is realized.

Challenges

There are a number of challenges to the use of P3s in federal real estate. One of the biggest impediments to P3s is the current budgetary scoring rules. Traditionally, the choice for agencies has been between traditional federal construction or operating leases (a midterm lease with no ownership option). For federal construction, the total construction cost of a project must be budgeted up front. For operating leases, typically only the first year of rent plus cancellation penalties must be budgeted for up front. In tight budget climates, operating leases appear to be more attractive. The Office of Management and Budget Circular A-11 sets forth guidance on how leases are scored. If a lease arrangement is determined to be a capital lease instead of an operating lease, the total cost of the project is scored up front. Among the characteristics of a capital lease includes eventual government ownership of the asset, the lease term exceeds 75 percent of the estimated economic life of the asset, and the present value of the minimum lease payments over the life of the lease exceeds 90 percent of the fair market value of the asset. Many P3 arrangements are likely to be scored as capital leases. As a result, they become as difficult to do as construction projects given that the total cost of the project would be scored up front.

Examples

State Courthouse – Long Beach, California – Design-Build-Finance-Operate-Maintain (DBFOM) project to build 585,000-square-foot courthouse with 31 courtrooms, holding cells, jury rooms, and second-party leased space. Cost of $500 million for 35-year term. Penalties for failures on performance including the availability to use space. P3 responsible for all capital, energy guarantees.

Military housing – Barksdale AFB, LA, Langley AFB, VA, and Bolling AFB, Washington DC – Approximately 1,025 acres, construction started 2008, total cost $1 billion. Project includes 1,731 new homes constructed, 383 homes renovated (360 historic), 2,090 homes demolished, with 3,189 homes expected at completion. Initial development period is seven years and total lease term is 50 years. Renovation and new construction is being financed privately without traditional upfront military construction funding.

Ford Island, Pearl Harbor, Hawaii – U.S. Navy exchange of 1,600 acres of land in Oahu for significant infrastructure and other improvements at Ford Island. These improvements include electrical, communications, sewage and road infrastructure upgrades, restoration of historic structures, construction of 231 new and renovation of 280 existing military homes, and mixed-use development of underutilized and abandoned property.