P3 Bulletin

Model Behaviour

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The design, build, finance, operate and maintain model (DBFOM, or the International Model) for P3 delivery has struggled to penetrate the US social infrastructure market.

Where it has succeeded, it has been limited to very large and complex projects, generally those that exceed $400m in cost.

Projects of this magnitude are subject to long project delivery timelines, mushrooming project costs, and are feasible only in very large municipalities with the political will and resources for large and costly projects. To date, only a handful have been completed in the US using the International Model.

There is another way. The National Development Council (NDC), a New York-based not-for-profit organization, has pioneered a model of P3 delivery that has proven successful on smaller deals beginning at a value of $20m.

The American Model uses privately issued tax-exempt debt, private development, ownership, and management of the facility for the life of the debt, coupled with the transfer of the asset to the public client at the retirement of the financing.

Using the American Model, NDC has completed 37 projects exceeding $2bn in project costs, with three additional projects slated for 2015 and another two in the design phase for 2016. Development partners on NDC's American Model projects have included numerous high profile national and regional firms including Balfour Beatty, Wright Runstad & Company, Trammell Crow Company, and Turner Construction among others.

Like DBFOM, the American Model is a true P3 approach that privately designs, finances, builds, operates and maintains facilities for the public sector, but it differs in two key aspects.

Firstly, it utilizes the American system of tax-exempt financing structured either as 501(c) (3) bonds issued through a conduit issuer or as 63-20 bonds issued directly by a not-for-profit organization.

These tax-exempt bonds can be used to fund 100% of a project's cost, simplifying the financing structure and eliminating the need for costly equity investment. By virtue of the differing requirements in the exempt and conventional financing markets, the overall project costs derived from the capital stack of an exempt financing can be 100 to 200 basis points lower than that of an exempt structure.

The second key difference is that under the American Model, the not-for-profit owner contracts facility management services through a series of short-term (three to five-year) management agreements with market-driven compensation. This comes instead of a long-term management agreement requiring complex performance rewards and guarantees. The private management company is not required to assume any operating risk because maintenance and repair costs are funded by the government tenant.

This management structure mirrors that most commonly used for private real estate management. It is much simpler and arguably more efficient than the performance-based contracting models used in DBFOM.

Tax-exempt bonds have long been thought of as a tool available only to governmental entities engaging in public works projects.

However, when issued by a private not-for-profit borrower, tax-exempt bonds can be used to build governmental buildings through a private development process. Under the American Model, the development approach is best described as Integrated Project Delivery with incentives to encourage cooperation, collaboration and efficiency among team members. This approach allows public partners to benefit from the creativity, efficiency, and ultimate cost-savings of private contracting and delivery. It is attractive to private sector partners because it opens the door to development opportunities that may not have been feasible under DBFOM.

Because it is effective in financing projects starting at $20m, the American Model opens the P3 social infrastructure market to moderately sized projects. This scale is more likely to be pursued by mid-sized cities and counties. Very few government entities are able to support mega-projects like the nearly $500m George Deukmejian Courthouse in Long Beach, California.

Far more frequent are projects such as the Riverside County Law Building, a build-to-suit facility constructed for Riverside County in Indio, California. With a total project cost of $44m, the law building was of typical size for public development projects. The project was completed using the American Model, with a private sector development team engaged to design and construct the facility on a fee basis.

The developer was provided with incentives for achieving cost savings, and in the end participated in the $4.2m project savings remaining at the completion of construction. The LEED Platinum building opened four months ahead of schedule in December 2014. It is currently operated for the county and not-for-profit owner by a private sector management firm contracted through a negotiated market rate management agreement.

King County, Washington State's most populous county with more than two million residents, has completed five P3 projects since 1997, with two more planned to begin construction in 2015. Six of these are in the $30-100m range. The largest had a total project cost of $190m, well below the threshold required for the International Model or DBFOM, but squarely in the range of the American Model's financing scope.

In fact, of the 39 projects NDC has completed across the country, only four have had a development cost over $100m. Projects like these, including city halls, law and court buildings, student housing, public research facilities and other municipal facilities, represent a great untapped market for the P3 industry. The American Model is a viable and proven tool that can service that market.