# SPENDING AFFORDABILITY ADVISORY COMMITTEE

# COURTHOUSE PROJECT REPORT

**Fiscal Year 2018**

# Spending Affordability
# Advisory Committee

Steve W. Sachs, Chair of the Spending Affordability Committee

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Craig Glendenning, Howard County Auditor
Stanley Milesky, Director, Department of Finance
Lonnie R. Robbins, Chief Administrative Officer
Jahantab Siddiqui, Deputy Chief of Staff, Office of the County Executive
Holly Sun, Budget Administrator
Larry Twele, Howard County Economic Development Authority

## Executive Summary

The Committee was tasked by the County Executive to make recommendations on the proposed new courthouse construction project given its size and potential consideration of P3 (public private partnerships), a relatively new project delivery approach. Further communications with County Council confirmed a similar desire for this Committee to conduct reviews and offer our advice on this project before elected officials make final decisions.

The Committee met several times in December 2016 and January 2017, listened to and discussed presentations from the honorable Lenore Gelfman, Howard County Administrative Judge, consultants and county staff and reviewed various materials. On January 18th, 2017, the Committee unanimously recommended using the following approach to deliver the new courthouse:

- The County should use a hybrid P3 approach combining public financing and private financing with design, build, operation and maintenance in a 30-year contract (Option 3. DBfOM in the four options presented by the consultants)

The Committee recommends this approach due to its multiple comparative advantages, including: shifted risks (financing, operational and lifecycle maintenance) to private partners; lowest estimated project cost in 30-year period; incentives and enforcement capacity for high performance and efficiency gain; faster project delivery; and predictable long-term operation and maintenance (O&M) cost. After carefully evaluating various delivery options, including their fiscal impact and other financial and operating pros and cons, we believe our recommendation is in the best interest of the County in the long run.

This report summarizes key analysis, findings and recommendations. Additional details can be found in the appendix - a comprehensive report by IMGRebel, the County's consultants on P3 financing. The appendix summarizes their presentations to the committee during the three meetings including indicative financial and service implications of various models and also technical details and reference materials such as case studies.

## Background

The following information was provided to the committee by Judge Gelfman and County staff prior to analysis of the financing options:

- The County courthouse opened in 1843 (over 174 years ago).
- The building structure has been renovated a few times during its history.
- The redevelopment of the courthouse has been delayed numerous times over the past 20 years.
- The building does not allow for the State approved 6th judge, technology enhancements, and required Federal and State mandates for case administration and processing.
- Based on engineering studies, the existing building cannot be further renovated to solve space inadequacies.
- Current capital projects do not include advanced planning for future O&M.

- County staff has completed an architectural and engineering study that determined a new building is the only viable solution.
- Construction costs for the 227,000 square foot building and 600 space parking garage are estimated at $138.7 million (this has been used in all modeling).
- 9250 Bendix Road, Bendix Road, Columbia MD 21045, a County-owned site with no land acquisition needs, is the proposed site.

**Delivery Options**

Traditionally, the County's capital projects were delivered with public financing using General Obligation (GO) bonds, and utilized competitive bidding for design, (separate) competitive bidding for construction, and usually multiple short-term contracts for operating and maintenance (O&M) needs once the building was completed and in use.

In the past two decades, public projects delivered through P3, or public private partnership, have gained increasing interest and application in the United States. P3 features a medium or long term contractual arrangement between a Public Agency and a Private Body for delivery of a public service or infrastructure for which the Public Agency remains accountable. This approach is procured through a competitive procurement process, where the required service or infrastructure is specified as an output and significant risks are transferred to the private firm, making its private investment and financial returns linked to its performance.

To identify the best options for the Courthouse project delivery, the County asked its financing consultants to provide potential options with detailed quantitative and qualitative analysis. The consultants studied and presented four models to the Committee, including conventional delivery, two different hybrid P3 approaches, and full-fledged P3 as the following:

- Option 1. Conventional Model (DBB+OM): public financing with County 30-year GO bond; traditional design and build; and multiple short-term operate and maintain contracts
- Option 2. Hybrid P3 – 1 (DBOM): public financing with County 30-year GO bond; design, build, operate and maintain
- Option 3. Hybrid P3 -2 (DBfOM): partial public financing and partial private financing tentatively assuming 50/50; design, build, operate and maintain
- Option 4. P3 (DBFOM): full private financing; design, build, operate and maintain

For each model, the consultants provided high-level risk analysis, value for money assessment, financial analysis (covering 30-year financing and O&M), and the County staff provided analysis on operating budget impact, debt indicators analysis and implications on credit ratings. The consultants also presented qualitative comparison of different delivery approaches, in term of risks allocation, quality improvement, overall project cost certainty, procurement time, procurement cost, completion certainty, and construction time. (Detailed qualitative and quantitative analysis can be found in the appendix)

Financial analysis indicated that 30-year total project cost including financing and O&M based on net present value (NPV) is projected to range from $289 million to $328 million, and first full year impact is estimated at $14.4 million ~ $16.7 million around 2022, depending on the option. County budget and finance staff noted that the projected annual costs for all four options are affordable (with full year impact representing 1.1%~1.3% of the County's operating budget and major impact phased-in over two years), and none of the presented options would trigger changes to the County's current AAA bond ratings, holding all other variables constant.

In analyzing and comparing those options, the Committee carefully evaluated multiple factors, such as: project cost, project completion timeframe, risk aversion/shift level, O&M quality and efficiency, predictability of future costs, performance enforcement capability, etc. The following table summarizes major findings based on key criteria used in evaluating the four project delivery options, with assigned score between 1~4 (1 indicating the most favorable result and 4 indicating the least favorable result):

| **Key Evaluation Factors** | **Note** | **Option 1. Conventional (DBB + OM)** | **Option 2. Hybrid P3-1 (DBOM)** | **Option 3. Hybrid P3-2 (DBfOM)** | **Option 4. P3 (DBFOM)** |
|---|---|---|---|---|---|
| Project Risk | 1=least risk | 3 | 2 | 1 | 1 |
| Project Cost | 1=least costly | 3 | 2 | 1 | 4 |
| Quality (building and O&M) | 1=highest quality | 4 | 3 | 2 | 1 |
| Long-term Cost Certainty | 1=highest certainty | 3 | 2 | 1 | 1 |
| Completion Time | 1=fastest delivery | 3 | 1 | 2 | 2 |
| Total | | **16** | **10** | **7** | **9** |

Note: "Total" is listed for illustration purpose only because factors do not carry the same weight in decision making.

## Recommendation

On January 18th, the Committee discussed all the options and unanimously recommended Option 3. Hybrid P3-2 (DBfOM) based on the following reasons:

- Shifts a high level of (financing, operational and lifecycle maintenance) risks to the private partners.
- Forecasts the lowest project cost in the long run, benefiting from both relatively low interest payments from (partial) public financing and cost savings in construction and O&M from P3.
- Keeps the building in good operating condition with contracted life-cycle investment.
- Provides both incentives and enforcement ability for high performance and efficiency gain with private partners sharing part of the financing (with "skin in the game").
- Offers ability for efficiency gain and cost savings through competitive bid and integration between building design and long-term O&M needs in one contract.
- Offers relatively fast construction delivery schedule compared to conventional model.
- Provides high certainty or least volatility on future cost.

The Committee did not recommend the conventional approach due to our concerns on: deferred maintenance, which is common for typical county capital projects; Government absorbing preponderance of all risks which causes uncertainty and often higher than planned costs in the future; and slower construction delivery.

The full P3 model DBFOM was not selected primarily due to its relatively high overall cost as a result of higher interest costs with 100% private financing, which will not likely be offset by anticipated efficiency gains and savings in O&M.

The Committee also eliminated the other hybrid model (DBOM), which uses public financing and private delivery of services. While it looks appealing on first sight, the DBOM approach implies significant risks with the County holding 100% of financing risks and also high risks in performance enforcement.

**Conclusion**

In summary, the Committee recommends that the County use a hybrid P3 approach with mixed public and private financing to deliver the new courthouse. This approach combines the benefits of lower financing cost from partial public financing and the benefits of optimum design, efficiency gains, high quality maintenance and risk transfers from a public private partnership.

The Committee also encourages the County to explore potential options to decrease the project's long-term cost where feasible without hurting its main purpose (e.g., replacing the 600 space garage with ground parking or utilizing revenue bonds financing; using potential proceeds from selling the existing courthouse to lower the total amount needed for financing, etc.).

We would like to thank all the Committee members for their time and effort in participating on the review and discussion of this project, providing insight and thoughtful ideas. We also want to thank all presenters, including IMG consultants and County staff for conducting complex analysis and preparing needed information in a relatively short period of time for the Committee.

We appreciate the opportunity to offer our advice for an important capital project that has long-term impact on government services to its citizens. The recommendation is a result of our due diligence and is based on information received from the above referenced sources. We hope our recommendation is of help to County decision makers.