The American Model ™: Our Approach to Public-Private Partnerships

The definition of Public-Private-Partnership runs the gamut from privatization of public assets to public assistance (i.e. Subsidies) of private development. There is potential for a symbiotic relationship between the public and private sectors, a partnership based on fair allocation of risks and rewards coupled with a balanced assignment of tasks to those best equipped to accomplish them. In our experience, the proper balance and alignment of these activities differs in every project. With few exceptions, there are two general rules that should be considered in structuring a fair public-private partnership:

1 - Public debt structures are less costly than private debt structures

Tax-exempt debt is less costly than taxable debt. Tax-exempt debt operates on a longer term, has a fixed rate and a low cost. Frequently, it provides 100% of the financing needs of a project and alleviates the need for costly equity. Taxable debt usually requires that a portion of the project be funded with equity. Equity is much more costly than either tax-exempt or taxable debt and can dramatically increase a project’s total cost. Public facilities do not have market rate tenants to pay the higher returns that financing with equity demands. Thus, public debt structures are nearly always better suited for public facilities.

2 - Private development is more efficient than the public development process

Unlike roads or sidewalks, city halls or municipal office building projects are undertaken once every few decades. When it comes time for a public entity to embark on a construction project, it is generally as concerned with consensus, procedure, and public perception as it is with outcome. In the private sector such concerns, while not totally absent, are clearly secondary to the primary goal of a cost efficient project delivery. In order to accomplish this goal, the private sector focuses on an achievable task and must efficiently accomplish that task.
How can we use the advantages of The American Model™?

NDC’s approach to public-private partnerships blends tax-exempt debt with private development expertise. To do so we set up a not-for-profit owner/issuer of tax-exempt bonds, hire a private developer, architect and general contractor and charge them with developing the facility. This development team is under contract to take construction and delivery risk. They are given the tools to do so, including incentives to build efficiently and to strict quality standards.

After construction is complete, the facility is leased to the governmental client and then transferred to the client at no cost when the debt is retired. Rent, dictated by the lease, is set at the debt service plus operating costs. There is no operating profit nor disposition profit since the development team is not required to bring equity to the structure or take on operating risk. The development team earns a development fee commensurate with the development risk they take on and nothing more.

Five Steps

Step 1: Selection of the not-for-profit

It is critical to select a not-for-profit with the skills and experience necessary to oversee a complex real estate project and to issue debt and be responsible for tax-exempt bond compliance. The not-for-profit should not be paid directly by the governmental client. Their duties are to finance and own the facility and they should receive a small fee of the bond proceeds. Even though the not-for-profit is selected by the governmental client, they issue and own the bonds and so their fee is a project cost not a consultant cost.

How the not-for-profit is selected should be governed by local requirements. It is most often done by RFQ, but this may not be necessary since there is no contractual relationship with the local government until the facility is designed and the government signs a lease.

Step 2: Selection of the Development Team

The development team consists of a Developer, General Contractor and an Architect. The selection process involves an RFQ, followed by an RFP. The RFQ process asks for team members, their qualifications, and their experience. It does not ask for design concepts or costs. Its goal is to select the 2 or 3 (never more) most qualified teams to do the job.

The RFP process should be more refined, however, it is still designed to elicit information on just 5 basic issues.

1. Who will work on the project and what is their experience?
2. Why the proposed team is the best choice and what ideas do they have to create value?
3. The RFP provides the not-for-profit’s Development Agreement that obligates the team to deliver the project on budget and on schedule and asks if they will accept it.
4. Asks the team to provide an estimated hard cost per square foot budget and to bid all fees and soft costs.
5. It asks for financial information.

The RFP process does not ask for design! Too often, selection committees are distracted by concept drawings that will have little relationship to the final design and neglect the more important selection criteria. Design comes in the Pre-development step.

Step 3: Pre-Development

The governmental agency contracts for pre-development services through the not-for-profit or directly with the development team. If contracted through the not-for-profit, this is the first contract between the not-for-profit and the governmental agency. This contract covers out of pocket costs. It does not include profit. Its goal is to fund the design and entitlement work to the point of establishing a Guaranteed Maximum Price. It should not include full costs because it is important that the team design to the governmental agency’s wants and to its cost parameters.

Step 4: Contracts

During the later stages of Pre-Development, the financing team, which includes the not-for-profit, the underwriter, underwriter’s council, bond counsel, trustee, and governmental entity (tenant), drafts the financing documents, the lease and other real estate documents.

Step 5: Bond Sale, Construction Occupancy and Management

Once built, the facility is owned by the not-for-profit and leased to the government at cost. Whenever the debt is retired, the facility is transferred to the governmental tenant at no cost.