
Public-private Partnerships

**Presentation to the
Appropriations Committee**

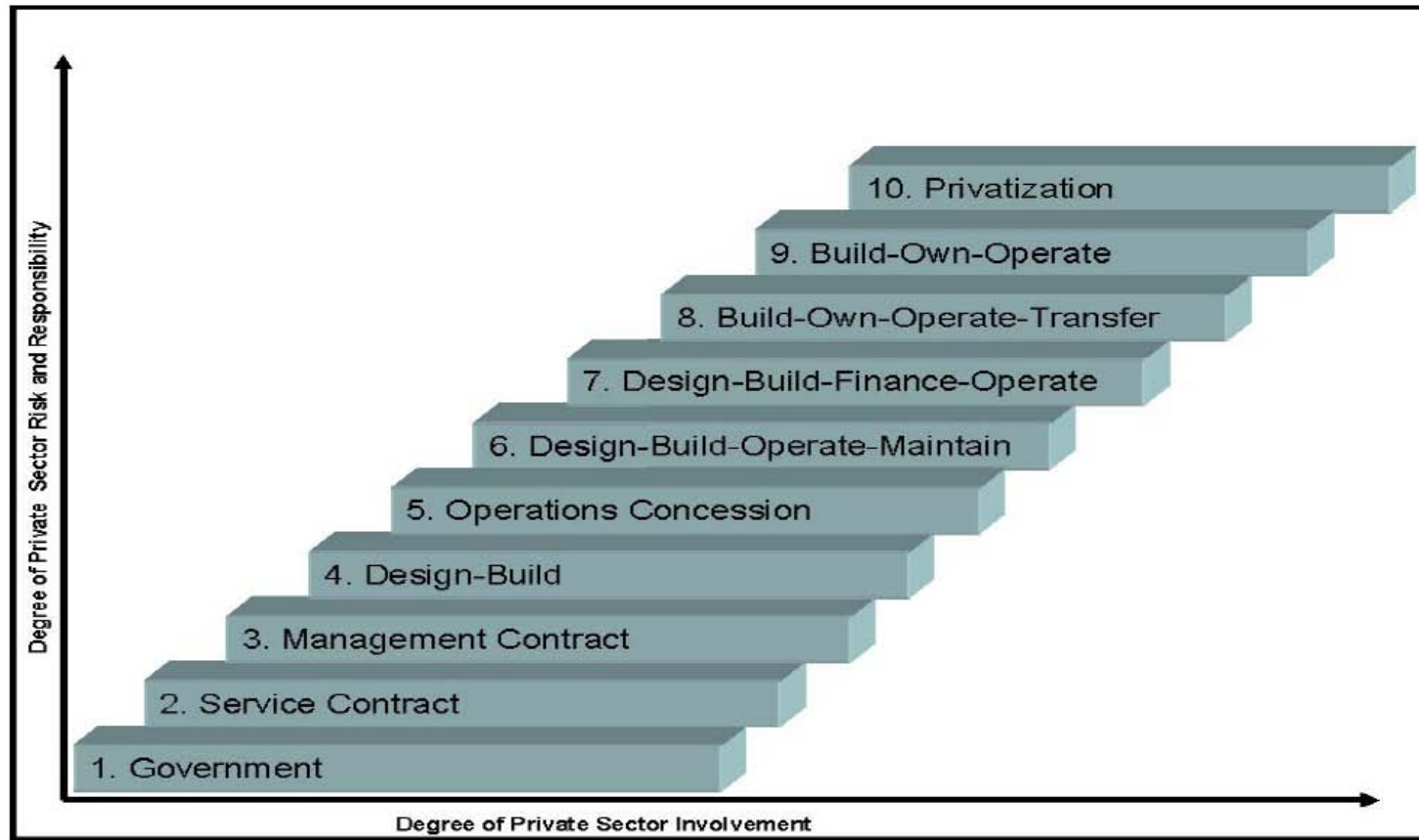
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Public-private Partnerships Defined

A public-private partnership (P3) is a contractual agreement between a public agency 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. Each party also shares in the risks and rewards potential in the delivery of the service and/or facility.

Types of P3 Arrangements



Source: Accounting and Financial Reporting for Service Concession Arrangements, March 2008, International Public Accounting Standards Board

P3s – Old Versus New Assets

- Brownfield projects – P3s involving long-term leases or concessions of existing facilities
- Greenfield projects – P3s involving the construction and long-term operation of new facilities

P3 Projects in Maryland

- University System of Maryland (USM) student housing
- I-95 travel plazas
- Transit-oriented development
- Seagirt Marine Terminal
- Redevelopment of State Center
- Public health lab

University System Housing

- Began in 1998 to maximize the use of debt
- Includes 14 student residences at 7 campuses
- Maryland Economic Development Corporation (MEDCO) issues debt on behalf of the private partner
- USM does not provide any occupancy guarantees
- Student signs lease with private partner so USM maintains an arm's length from the transaction
- Higher interest rates and increased rating agency scrutiny have made these deals more challenging

I-95 Travel Plazas

- On November 12, 2009, the Maryland Transportation Authority (MDTA) provided legislative notice of its intent to issue a request for proposal (RFP) for the redevelopment and long-term operation and maintenance of the two travel plazas on I-95
- Includes the Maryland House and the Chesapeake House
- MDTA seeks a 35-year term
- MDTA seeks to receive an annual percentage of gross operating proceeds from the developer
- Issuance of an RFP, originally planned for December 2009, has been delayed by several months to allow MDTA more time to complete the document

Transit-oriented Development

- Includes projects that create mixed-use development adjacent to transit stations
- Transit-oriented developments (TODs) can take a number of different forms, involving different levels of State, local, and private involvement and funding
- Current TOD projects include Savage, Owings Mills, Odenton, Laurel, and Reisterstown Plaza
- The budget committees receive notice of these projects in an annual report listing each project and notice of all solicitations and Board of Public Works' (BPW) considerations of agreements

Seagirt Marine Terminal

- On December 16, 2009, BPW approved a 50-year lease of Seagirt Marine Terminal to Ports America Chesapeake (PAC)
- PAC will fund and construct a 50-foot berth at Seagirt and purchase additional cranes, for a total estimated cost of \$105.0 million
- PAC will make an upfront payment of \$140.0 million to MDTA to repay its investment in the construction of Seagirt
- The Maryland Port Administration will receive annual rent payments of \$3.2 million and incremental fees based on increases in business
- Financing for the deal was provided by a \$75.0 million equity contribution from PAC and \$248.7 million in lease revenue bonds issued by MEDCO on behalf of PAC

Lessons Learned from Seagirt

- A 15-day notification period prior to BPW approval of the agreement is not adequate time to allow complete analysis and action by the legislature
- Determining the value of an asset and whether the deal is good for the State are made difficult by long contract terms
- Clauses common in P3 contracts, like adverse action and noncompete, may place limitations on the legislature for the life of the contract, and require financial penalties if not abided by
- There is a delicate balance between the openness of government and the confidentiality required during negotiation of these agreements
- In many cases, the legislature will have to review and approve deals without the financing in place
- Minority Business Enterprise (MBE) participation cannot be required, only encouraged

State Center Redevelopment

Current Project Timeline

- BPW approved the Master Development Agreement on June 3, 2009
- In August 2009, the Maryland Department of Transportation (MDOT) expected a negotiated lease agreement for Phase I by September 2009
- In September 2009, MDOT altered the timeline for Phase I approval to the end of calendar 2009. Phase I approval is now delayed into early 2010.
- Projected Phase 1 Occupancy by State in fiscal 2014

Oversight Modifications

- July 2009 State Center Executive Committee expanded to include Senators DeGrange and Jones and Delegates Branch and Clagett
- Oversight role of Maryland Stadium Authority expected to be defined and formalized by October 2009

Status of Development Team

- Development team reconstituted in spring 2009:
 - PS Partners/Ekistics Capital Partners
1/3 funding
 - McCormack, Baron, & Salazar 1/3 funding
 - MBE to be determined 1/3 funding
- Selection of new MBE partner was expected in fall 2009

Phase 1 Evolution

- Parcel G
 - Department of Health and Mental Hygiene (DHMH) Offices
333,000 square feet (sf)
 - Other State agencies approx 40,000 sf
 - Private office space reduced to 15,000 sf
- Developer outline contemplates possibility of adding a public school as part of Parcel G
- Parcel I advanced from Phase 2 to Phase 1
 - 100,000 sf office space for Maryland Transit Administration (MTA) and 15,000 sf retail space

Parcel G Evolution

2009 Session

Phase I	Office	State	375,000
	Office	Private	208,400
	Retail	Grocery	76,000
	Parking	939 Spaces	523,800
	Residential	137 Units	177,600
	Subtotal Parcel G		1,360,800

December 2009

Phase I	Office	State	375,000
	Office	Private	15,000
	Retail	Grocery	50,000
	Retail	Other	30,000
	Parking	930 Spaces	523,800
	Residential	100 to 130 units	166,600
	Subtotal Parcel G		1,160,400

Parking Garage Development

- 30-year MEDCO bonds
- Fewer spaces for State employees
 - From 1 space per 3 employees to 1:4 ratio
- Debt service of approx. \$3.3 million funded by the Transportation Trust Fund
 - New parking fees for State employees
 - Net revenue \$500,000-\$600,000

Phase 1 Lease Term Potential Changes

2009 Session

- Ground lease 50 years with two 20-year options
- Operating lease term from 5 to 15 years

December 2009

- Ground lease 65 years with one 25-year option
- 20-year operating lease term to satisfy market for bond financing

Effect of Credit Crisis on TIF Bonds

- August 2009 MDOT reported that two TOD projects (Savage & Owings Mills) were on hold because the national credit crisis prevented the issuance of Tax Increment Financing (TIF) backed bonds
- Developer outline suggests Phase 1 of State Center may be able to use existing infrastructure & TIF can be in place later

Rent & Impact on State Budget

- As of December 2009, estimate is for rent in FY 2014 to cost \$36.88 per sf, increasing 15% every 5 years
- NEW lease contingency for Payment in Lieu of Taxes (PILOT) agreement with Baltimore Development Corporation to set property taxes at \$2.50 per sf

Lease Payments to the State

- State will receive reimbursement for appraised value of land used for first phase, amortized over 20 years
- Simultaneous to developer's pre-development reimbursement (4th in line behind debt service, reserves, and preferred developer return)
- After 20 years, State gets developer's choice of \$375,000 or 8.0% value of land, increased 3% per year
- State gets 12.5% capital events (sale or refinancing)

Observations

Occupancy Lease

- **Status of the Phase 1 Occupancy Lease?**

MTA Farebox

- **Impact of State Center rent on MTA farebox recovery level (FY 2009 at 31%, below 35% requirement). Additional rent costs will worsen noncompliance with statute.**

Observations

Financing

- **Effect of long-term credit crisis on TIF bonds and infrastructure needs is unknown**
- **Status of MBE partner for 1/3 of funding is unknown**

Policy precedents

- **TTF subsidizing parking garage bonds for TOD projects**
- **State employee monthly parking fees**

Observations (cont.)

Project Oversight

- How much time will the legislature have to review the proposed Phase 1 operating lease?
- Oversight of project changes

Use of State-owned Space in Schaefer Tower

- What agency will move into State-owned space in Schaefer Tower and will it move from currently leased space?

Observations (cont.)

Rent

- **What are details of PILOT with Baltimore Development Corporation (who pays, how much)?**
- **Impact on State budget unclear**

Project Viability

- **Commercial office space vacancy rate increased from 12.0% (2008) to 18.8% (2009) in Baltimore City**

DHMH Public Health Lab

New Public Health Lab

- The proposed new 198,000 gross square foot facility will replace the existing 35-year-old inadequate, outdated, and unsafe laboratory
- Problems with the current facility include:
 - insufficient and obsolete laboratory space;
 - deteriorated building infrastructure and poor environmental conditions pose high risk of operational shut-down; and
 - facility design and location that pose security risk and potential health risk to occupants

Timeline

- **2006 Session: Project Added – Emergent Nature of Project** – Initial authorization – \$9.4 authorized for preliminary design despite no Program Plan for project
- **2007 Session: Lack of Program Plan Stalls Project** – Initial authorization is deauthorized – preauthorization provided for the 2008 session capital budget – committees require consultant studies on alternative financing mechanism and program review
- **2008 Session and Interim: Project Review Stalls Project** – Administration proposes striking the preauthorization provided in 2007 session – committees agree but stress the need for the project. Consultant review of Program Plan results in scope reductions and estimated cost savings. Alternative Financing Mechanism Report completed (not made public until January 2009), traditional GO bond financing lowest cost alternative – MEDCO lease revenue bond financing purported to avoid scoring financing as State debt and allow limited GO to fund other State priorities

Timeline

- **2009 Session and Interim: Administration announces intent to use MEDCO lease revenue bond financing & project removed from the *Capital Improvement Program (CIP)*** – Budget authorizes \$6.5 million to fund pre-development but restricts use pending Capital Debt Affordability Committee (CDAC) review of debt affordability implications of alternative financing and further review of cost alternative implications – the Department of Legislative Services (DLS) and MEDCO present reports to CDAC outlining financing alternatives and debt affordability implications
 - **General obligation (GO) bond financing** cheapest alternative and if funded within the planned new GO authorization levels would not add to the amount of State supported debt or add additional annual operating budget costs to finance – the “cost” is in the projects deferred to accommodate the lab within GO bond authorization limits
 - **MEDCO financing** costs dependent upon length of financing (longer bond maturities increase total cost but reduce annual General Fund lease costs) – estimated cost if structured as a capital lease lower than if structured as an operating lease but a capital lease would count as State supported debt while an operating under current standards might not be scored as State debt by rating agencies (CDAC advises that it would be prudent for the State to consider an operating lease as State supported debt given nature of project – since the amount is low, the impact would be negligible)

Financing Alternatives – Pros

MEDCO Issued Lease-revenue Bonds

- Offers accelerated project delivery – up to 18 months sooner
- Lower estimated design and construction costs – up to \$8 million
- Would establish a dedicated facility renewal and replacement fund
- Would not require the use of limited GO bond authorizations in the 2010 session – flexibility to use capacity to fund other alternatives

Traditional GO Bonds

- GO bond financing offers the lowest total principal and interest costs
- If funded within current projected GO bond authorization limits, no impact on State operating budget – no additional general funds would be required to service the debt
- If funded within current projected GO bond authorization limits, no impact on State debt limitations

Financing Alternatives – Cons

MEDCO Issued Lease-Revenue Bonds

- Most expensive total principal and interest costs – costs vary depending upon the length and type of financing
- Impact on annual operating budget – ranges from \$11.5 to \$17.0 million annually depending upon the financing terms (not including other ancillary operating costs attributable to each financing alternative)
- Whether structured under an operating or capital lease with the State, the financing is likely to impact State debt limitations

Traditional GO Bonds

- Project would take longer to complete and have a greater total design and construction costs due to more stringent State procurement requirements and budgetary cycle
- Facility renewal and maintenance would be subject to the vagaries of the annual budget
- Project is not currently in the State's CIP – accommodating the estimated \$165 million project within current GO bond limits would necessitate deferral of other capital priorities

Other Issues

- Lack of statutory provisions to require “buy-in” by legislature – Administration’s alternative financing plan only requires BPW approval of contracts
- Without notification at early planning stage, it is difficult to require legislative review at the point that contracts have been negotiated and ready for BPW consideration
- Alternative financing of State facilities requires consideration of costs, budget impact, and debt affordability prior to execution

Other Issues – Cont.

- Status of Land Acquisition: MEDCO intends to purchase the building site from East Baltimore Development Corporation – acquisition costs and financing are still in negotiation
- PILOT: The site selected is within a special taxing district, and a PILOT must be negotiated with the State
- Build American Bonds (BABs): MEDCO has authority to issue BABs for the project which could reduce financing costs

Current Status

- Committees released restricted \$6.45 million GO bond authorization essentially agreeing to Administration's alternative financing mechanism using lease-revenue bonds – State to pay a cost “premium” to keep from having to accommodate project within GO bond authorization limits
- Interagency Agreement between DHMH, DGS, and MEDCO to be taken to BPW on January 20, 2010. This agreement will initiate the procedural and contractual milestones necessary to finance and construct the project using MEDCO

Legal Framework for P3s

Legal Framework for P3s in Maryland

- No comprehensive statutory framework governing P3s
- Legal framework differs for transportation and nontransportation P3s
- A patchwork of statute, regulations, budget bill language, and an Attorney General's opinion provides the framework for transportation P3s
- Only some project-specific budget bill language exists for nontransportation P3s

Legal Framework for Nontransportation P3s

- Statute currently does not reference nontransportation P3s – either to allow or to prohibit
- There are no statutory requirements for legislative notice or approval of nontransportation P3s
- To date, nontransportation P3s have been dealt with on a case-by-case basis
- Budget bill language included in the operating and capital budget bills addressed the State Center redevelopment and the public health lab

Legal Framework for Transportation P3s

- Until 2007, regulations promulgated by MDTA and an Attorney General's 1996 opinion governed P3s and did not require legislative notice or approval
- Chapter 383 of 2007 required MDTA to provide 45 days notice to the legislature before issuing a notice of procurement for a P3 and before entering into a P3
- Several pieces of legislation have been introduced over the last couple years to address legislative oversight of P3s, but all have failed

Legal Framework for Transportation P3s (cont.)

- Consensus has not yet been reached about the best approach to P3 agreements and oversight
- The current definition of P3s in statute does not cover all transportation P3s (excludes port and airport facilities), requiring action on a case-by-case basis
- Budget bill language included in the fiscal 2010 budget requires legislative notice for the Seagirt Marine Terminal P3 and for the I-95 rest stops
- An administrative process was established between DLS and MDOT that requires updates on TOD projects twice a year as well as more detailed information prior to BPW approvals

Need for Comprehensive Legal Framework

- Lack of unified statutory framework
- Projects can be addressed on a case-by-case basis when the legislature is aware of the project and acts during session with legislation or budget bill language
- However, if the General Assembly never becomes aware of the project or it happens in the interim, there is no chance to act
- General Assembly could choose to take a proactive rather than reactive stance on P3s

Legislative Oversight in Other States

- During the 2008 interim, DLS identified 25 states that have a statutory authorization allowing for P3s
- Several states have legislative oversight of P3s which includes a notification process, authorizations for a specific project, or policy objectives defined in statute
- Of the 25 states with statutory authorization, 5 states have a statutory process for legislative approval

Recent Actions in Maryland

Fiscal 2010 Operating Budget Bill

- Section 53 expressed intent that a joint legislative and executive workgroup be established to study issues related to legislative oversight of P3s. This workgroup did not meet during the interim
- Section 54 required DGS, MDOT, MDTA, and USM to submit reports listing all current and proposed P3s

Fiscal 2010 Capital Budget Bill

- Section 13 required an assessment by the State Treasurer and legislative notice prior to the issuance of a solicitation for a P3 or before entering into a master development agreement

Spending Affordability 2009 Interim Report

- Recommended that the State Treasurer evaluate the operating leases for State Center and the public health lab to determine if rent paid from State revenue sources would count toward State debt limits

Issues to Consider

General

- Should P3 projects be allowed?
- What types of projects are included in the definition of P3?
- Are both solicited and unsolicited projects allowed?
- Why should this project be done as a P3 instead of as a State project?

Other

- What if the private partner defaults on the contract?
- How can compliance with existing and future environmental standards be assured?
- For projects involving existing assets, what about the existing workforce?
- Who will handle future operations, security, and maintenance?
- Confidentiality vs. transparency

Issues to Consider (cont.)

Financial Considerations

- How will the project be financed?
- Which is better — upfront payments or revenue sharing over the term of the contract?
- If an upfront payment is received, how will those funds be used?
- Are there impacts on State debt affordability?
- What budgetary impact will the project have now and in the future?
- Who is responsible for deciding rate increases?

Legislative Oversight

- What is the legislature's role? Should notice or approval of the P3 be required?
- What information should be provided to the legislature?