

# Chapter 2

## Well-Designed Public Private Partnerships



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### Abbreviations

ADA	American's with Disability Act
AOC	Administrative Offices of the Courts
ASCE	American Society of Civil Engineers
DB	Design build
DBF	Design build finance
DBFO	Design build finance operate
DBFOM	Design build finance operate and maintain
DOF	Department of Finance
LLB	Lease lease back
NCPPP	National Council for Public Private Partnerships
OFS	Oxnard fire station
PBI	Performance-based initiatives
PPP or P3	Public Private Partnerships
RDA	Redevelopment agency
RFP	Request for proposal
RFQ	Request for qualification
ULI	Urban Land Institute

### Introduction

Our country's aging infrastructure is increasingly vulnerable due to impacts of severe weather, growing population in cities, and technology-driven, land-use patterns. According to the American Society of Civil Engineers (ASCE), years of

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neglect and systemic infrastructure deficits present significant challenges for both the public as well as the private sectors today.<sup>1</sup> On the other hand, such significant challenges represent unprecedented opportunities for leadership and investment of greater proportions for these sectors. Never have the public and private sectors been so interdependent, creating unique opportunities for intersectoral relationships or collaborations to deliver important public infrastructures. Arguably, the public policy and financial interests of these sectors have never been so clearly aligned for what could be the greatest social good since the Progressive Era ushered in by the strong voice of President Theodore Roosevelt's White House<sup>2</sup> or the New Deal proposed by President Franklin D. Roosevelt<sup>3</sup> immediately after the Great Depression of 1929–1939. While several procurement methodologies have brought the sectors together over the last century, none could have a more profound impact on our economy today than well-structured involvement of the private sector in the delivery of public infrastructures through the use of procurement and contracting arrangements broadly known as public private partnerships or technically referred to as performance-based initiatives or infrastructures.

Shortened to PPP, P3, or PBI for brevity, these arrangements are not business as usual. Individual variations of PPPs, including arrangements known as lease and lease back (LLB), can potentially provide a range of benefits or meet major policy objectives for growing cities, counties, and states, while placing private human capital and private financial capital into a historically secure sector, employing millions of Americans. Recognizing these benefits, governments worldwide and in the USA are increasingly considering PPPs or LLBs over traditional procurement and delivery methodologies to hire, integrate, maximize expertise, reduce risk, and tap into special resources for the planning, financing, designing, and building public infrastructure projects (Zerunyan and Meyers 2010). These projects range from forestry and agriculture to transportation and water infrastructures (Fig. 2.1).<sup>4</sup> According to the World Economic Forum, the global infrastructure deficit is \$5 trillion a year.

In this chapter, I discuss the variations of PPPs and LLBs, the range of services they provide, as well as the risks they distribute to be effective and efficient for the shared interest and value system that makes them attractive. I also provide examples of successful as well as some failed projects. PPPs are not magic bullets. While they have significant and transformational advantages to uplift more than one sector, not every public project is a candidate to use the methodology.

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<sup>1</sup>The 2017 Report Card found that the national grade for infrastructure remains at a “D+”—the same grade the USA received in 2013—suggesting that only incremental progress was made over the last four years toward restoring America’s infrastructure. <http://www.asce.org/infrastructure/>.

<sup>2</sup><https://www.gilderlehrman.org/history-now/2008-09/theodore-roosevelt-and-progressive-era>.

<sup>3</sup><http://www.loc.gov/teachers/classroommaterials/presentationsandactivities/presentations/timeline/depwwii/newdeal/>.

<sup>4</sup>The Organization for Economic Co-operation and development (OECD)-World Economic Forum.

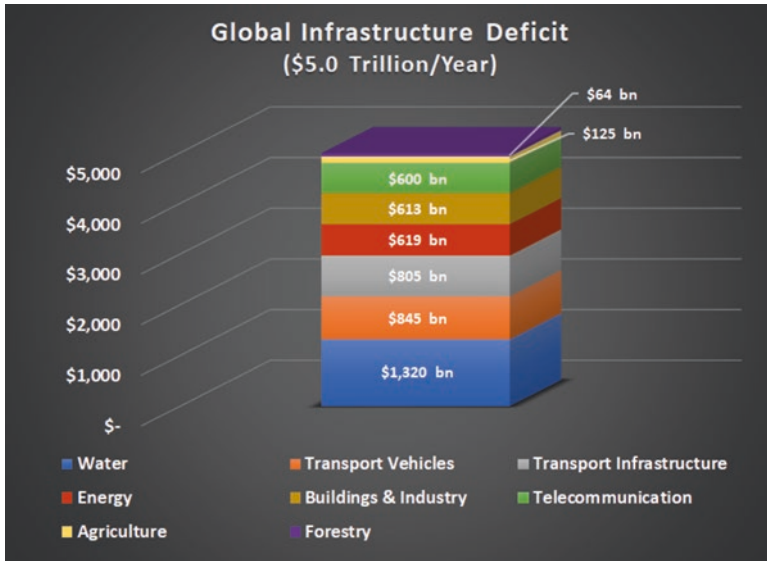


Fig. 2.1 Global infrastructure deficit

### *Public Private Partnerships as an Infrastructure Delivery Methodology*

PPPs are legal fictions. They are typically contractual arrangements between the public, the private, and sometimes the not-for-profit sectors. The National Council for PPPs (NCP PPP) developed a useful definition:

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 shares in the risks and rewards potential in the delivery of the service and/or facility.<sup>5</sup>

In exchange for a fee, typically the private sector delivers built infrastructures, facilities, and services. Leveraging the private sector to economically or socially benefit the public sector is a fairly new phenomenon in governance. PPPs have been used for a range of “economic” infrastructures in transportation, solid waste disposal, water and sewer services, and more recently parking. These “economic” infrastructures are generally fee-generating in nature, based for example, on actual use of a toll road, water service, parking, etc. “Social” infrastructures, on the other hand, do not generate revenues per use but are also attractive for PPPs. Schools, hospitals, court houses, police and fire stations, prisons, and other public buildings have used this methodology to benefit from PPP efficiencies. According to the NCP PPP, 37 states enable PPPs by statute, most in economic infrastructures and

<sup>5</sup> <http://www.ncppp.org/ppp-basics/7-keys/>.

more specifically in transportation.<sup>6</sup> Some are more structured and helpful than others. Only Arkansas, Indiana, Maryland, New Jersey, North Carolina, and Virginia provide statutory help in social infrastructures, except that California does have education code sections to facilitate schools, which I will discuss specifically in this chapter as a concept of PPP that we, in practice, label LLB.

One of the many fundamentally attractive features of PPPs is their ability to save time, money, and effort in the government procurement process. Governments seeking to use the methodology may consolidate many otherwise significant and time-consuming activities into a single solicitation. In other words, instead of hiring a designer (architect), arranging for financing, soliciting bids for construction, overseeing construction, and ensuring maintenance and repair over the life cycle of the infrastructure, governments may hire a competent group or a qualified “concessionaire” to perform all or some of these activities. Using this methodology, governments can focus on their core business of public safety and delivery of quality of life. Other potential benefits to governments include greater price and schedule certainty, innovations available in the private sector, and higher levels of maintenance, all of which I discuss in this chapter through specific examples.

PPPs are generally grouped by the range of services they provide. A well-informed and advised government, depending on its appetite for risk, may select one of several recognized PPP methods of delivering an infrastructure. This process may begin with government’s request for qualifications (RFQ) or similar procurement process to identify one or more suitable government partner. Typically, once several suitable partners are selected through the RFQ process, a request for proposal (RFP) follows to complete the solicitation. While the benefits of the methodology are remarkable for governments, some of its limitations may arise early in the process. Unless governments employ in-house or hire the necessary human capital to confront risks with a more complex procurement process or meet unforeseen challenges in the structuring of the methodology, PPPs may limit government flexibilities and increase costs.

An RFQ or an RFP is as good as the quality of the specifications and levels of sophistications written in the solicitations. In a 2012 report, the California Legislative Analyst’s Office,<sup>7</sup> based on expert input to which I participated, recommended that the state establishes an overall PPP policy to implement a transparent process. This requires government expertise in the methodology to precisely adopt criteria in the evaluation of good partner candidates and conduct rigorous value-for-money analysis. California still lags behind states like Indiana and Virginia in relevant policy, regulation, or laws guiding PPPs. For example, Virginia established an Office of Transportation PPPs<sup>8</sup> to institutionalize the procurement process by attracting qualified developers and builders transparent to stakeholders and the public. I advocated and continue to recommend PPP procurement policy be written in statutes to make the process more transparent and usable by various levels of governments in the

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<sup>6</sup><http://www.ncppp.org/resources/research-information/state-legislation/>.

<sup>7</sup>[http://www.lao.ca.gov/reports/2012/trns/partnerships/P3\\_110712.pdf](http://www.lao.ca.gov/reports/2012/trns/partnerships/P3_110712.pdf).

<sup>8</sup><http://www.p3virginia.org>.

state of California. For example, NCPPP developed 7 keys to success in PPP development. Among them is the requirement of a favorable statutory environment to implement each partnership. Transparency and the competitive proposal process written in statute only enhance the ability of each sector to participate to successful PPPs. An organized structure with a dedicated team can help each government in the procurement and implementation of each project. It is inefficient and too expensive for some levels of government (e.g., state, county, or city) to invent the wheel or reinvent the wheel so to speak to structure PPPs.

### ***Greatest Challenges in Designing Effective Public Private Partnerships***

PPPs are mostly long-term and performance-based initiatives. Like good governance, they are also based on accountability, efficiency, and results. Every stakeholder's interest in the partnership is to be fully informed and to know the parameters of the project. Contrary to the claims of some of the opponents of the methodology, no one in the partnership has the motivation to be misinformed or to misinform another partner. Therefore, PPP fluency in communication is paramount to the success of each project for both the public and private sectors. A common vision and a shared set of goals by both sectors, public and private, are paramount to the success of a PPP project.

Most known failures in this methodology come from optimistic data collection, lack of communication, and a blurred framework for project goals. For example, the initial failure of the 91 Express Lanes, a toll road in Southern California, came as a result of erroneous traffic counts, misinformation about alternative roads, and legal shortcomings in the contract, which were more positional rather than interest-based for the benefit of the project goals. Lessons learned from this project include complete transparency and the understanding by each partner that any substantial advantage or legal loophole created for one is a disadvantage to all and potentially may lead to the demise of the long-term relationship. My parents will celebrate their 60th wedding anniversary next year. They say that the success to their long-term relationship is transparency, communication, and care for the purpose of the union rather than self-interest. A 30-year PPP is no different. Entering into a PPP solely for self-interest is misguided and will prove to be fatal to the project. As a result, while PPPs are not a magic bullet to solve our infrastructure shortcomings, it is also not for every government, developer, contractor, financier, or designer to use as a methodology. In *Anna Karenina*, Tolstoy observed that "happy families are all alike; every unhappy family is unhappy in its own way." In short, to succeed, PPPs must be organized for success with full appreciation of the business model of the private sector, which values risk and life cycle costs of the asset for a sustainable future in earnings. PPPs must also be organized to benefit municipalities in long-term cost sharing, infrastructure maintenance, and delivery of other public services.

In the private sector, both risk and continued maintenance of capital facilities play a direct role in the profitability of the enterprise. Arguably, a Class A office building is predisposed to retain a proactive investment program for maintenance, repair, and refurbishment of its building to retain the levels of rent charged in similar Class A buildings. In other words, the motivation to maintain a building as a decision directly correlates to economics. Governments are not structured with this motivation. They are in the business of public safety, education, transportation, and generally, quality of life. These are very important for governance including economic development in the private sector, where real estate values for example directly correlate to public safety. In turn, vacant and abandoned real property increases crime, health risks, and therefore, the cost of municipal governance.<sup>9</sup> However, when the physical condition of courts, schools, fire stations, or city halls declines, there is no corresponding direct loss of revenue to signal unacceptability. As a result, government investments in maintenance and repairs either fall woefully short or are not provided at all. Many studies, including those by the Urban Land Institute (ULI), seem to correctly conclude that the integrated use of PPPs in economic and social infrastructure development may be a better way to design, build, finance, operate, and maintain public infrastructures if in fact the purpose for the use of the methodology is to save on life cycle costs, reduce risk to government, and maintain optimal standards of the capital asset during its long life cycle.<sup>10</sup>

Before examining the range of services PPPs provide, it is important to examine how to manage risk in the structuring of a successful PPP. In fact, one of the other attractive features of this delivery method is the proper allocation of risk to the party in the partnership most equipped to manage it (Fig. 2.2). If risk is not managed properly from the inception of the project, the cost of the project will increase. This allocation of risk across a continuum is rooted in full, open, and honest cooperation between the partners. If the objective for each party is to simply shift risk to the other, the PPP will be much less efficient or effective. The goal here is to transparently identify and equitably allocate risk to reduce cost. For example, political risks associated with changes in government, laws or regulations, unanticipated tax increases, or fee impositions are best managed by the government, which is responsible for them. If government asks the private sector to absorb these risks, the private sector may choose to do so in return for a fee, which unnecessarily increases the price of the project. On the other hand, construction risks, such as faulty design, delays in construction, poor performance, and poor quality, are all within the control of the private sector and can be properly managed or insured by it. Governments taking on these risks typically deliver projects of lesser quality teeming with cost overruns, schedule delays, and missed budgets. Other risks to be allocated include legal and contractual risks, which may be mitigated by proper representation. As is the case with the highly specialized pool of PPP partners, specialized law firms or professional consultants also create value in structuring these PPPs. Income risks based on faulty data, such as inaccurate traffic volumes for a toll road or the construction of a

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<sup>9</sup><https://www.huduser.gov/portal/periodicals/em/winter14/highlight1.html>.

<sup>10</sup><https://uli.org/wp-content/uploads/ULI-Documents/Successful-Public-Private-Partnerships.pdf>.



**Fig. 2.2** Risk continuum (DBFOM versus DB)

competing infrastructure, may reduce the effectiveness of the PPP. Financial risks and force majeure such as natural disasters, terrorism, or war may also affect the structuring of a PPP. While the private sector, for the right price, can deliver whatever governments want, as a matter of prudent policy, governments must assess these risks and costs. They must retain those that they may be able to control or manage to reduce the cost of the project.

In short, to achieve success in PPP procurement, risks must match the expertise and objectives of each participant to optimize implementation. Governments look for infrastructure to support public safety, economic development, and quality of life for their constituents. Governments also desire lower life cycle costs, timely repairs, quality products, and the ability to focus on their core functions. The private sector aims for a steady and most secure return on its investment. It wants the ability to use innovation to improve productivity to meet performance goals. The proper alignment of these objectives creates successful PPP projects. These constitute common goals that governments and private sector participants must discuss and achieve to see improvements in PPP arrangements.

Crafting effective PPPs requires skills for both the public and private sectors. The Urban Land Institute (ULI) describes these skills with “ten principals for successful public private partnerships.” The “ten principles include the following:

- Prepare properly for a public/private partnership
- Create a shared vision
- Understand your partners and key players
- Be clear on the risks and rewards for all parties
- Establish a clear and rational decision-making process
- Make sure all parties do their homework
- Secure consistent and coordinated leadership
- Communicate early and often
- Negotiate a fair deal structure
- Build trust as a core value (Corrigan et al. 2005).”



Fig. 2.3 ULI's public private partnership council survey results

In 2016, ULI's Public Private Partnership Council ran an informal survey of its membership. The survey identified 13 significant challenges in crafting effective PPPs (Fig. 2.3) (Long 2016). The top 3 survey responses ranging from 48.78% to a very significant 60.98% response rate clearly describe the importance of the "ten principals" in the implementation process. My experiences that I share in the case studies described in this chapter are not different.

From a very modest risk allocation to the private sector to a full transfer of risk, PPPs range in services to governments. The Public Contracting Code in California traditionally describes a design-bid-build process whereby the public agency describes in a solicitation its specific needs and awards separate contracts to architects, engineers, and construction firms. There is not much room for negotiations, and most risks remain with the public sector, except of course the specific costs associated with services sought and provided. The law requires the public agency to award the contracts to the lowest responsible bidder who submits a responsive bid.<sup>11</sup> A responsible bidder is typically a licensed contractor in good standing. In addition, a responsible bidder is deemed to have the equipment and skills necessary to perform the work described in the bidding documents. If the bidder does not fit this criterion, the public agency need not award the contract to the lowest bidder. The second requirement is that the bid be responsive. Quite simply, the bid must be an unconditional offer to provide all the goods and services that are being solicited. For example, a bid which excludes a portion of the work or fails to follow procedures set forth in the bid document is deemed non-responsive. This methodology is quite rigid and hardly a partnership.

<sup>11</sup> Public Contracting Code Sections (20161 and 20162).





Fig. 2.4 Risk continuum (DBFOM, DBFO, DBF, and DB)

The alternative project delivery methodology of Design-Build (DB) combines the design and construction phases of the project into one fixed-fee contract. The private sector designs and builds the infrastructure to specifications for a fixed fee. In the DB methodology, the risk of cost overruns is transferred to the private sector. Design-Build and Finance (DBF), Design-Build-Finance and Operate (DBFO) and Design-Build-Finance-Operate and Maintain (DBFOM) are all various iterations of PPP methodology describing private sector’s responsibilities and assumption of risks (Fig. 2.4). Depending on the needs of the public sector, procurement may take different forms for best results. While different factors such as value for money, risk, life cycle costs influence the successful implementation of procurement, there is considerable literature and studies focusing what amounts to be the strong motivation of the private sector to act responsibly when it must design, build, finance, operate, and maintain an infrastructure. This, of course, is because of the assumption that the private sector has a greater incentive to innovate along with maximizing profits.<sup>12</sup>

### Lease and Lease Back as a Methodology

While PPPs have a long-proven record internationally, leveraging the private sector to socially benefit the public sector is a fairly new phenomenon in the USA, especially in the context of social public spaces. PPP or LLB can provide a range of benefits or meet major policy objectives for municipalities if competently and appropriately applied. LLBs like PPPs are not magic bullets in building public spaces, but they come with very attractive advantages. They are typically “turnkey

<sup>12</sup><https://www.nao.org.uk/report/good-practice-briefing-for-pfi-ppp/>.

delivery” projects where the private sector assumes at least construction and delivery risks. The construction price is guaranteed, and no payment is due until occupancy is delivered to the municipality based on a measurable outcome.

California’s Education Code contains a well-designed statutory scheme to permit public private partnerships using the LLB methodology.<sup>13</sup> Section 17406 of the Code permits the governing board of a school district to let, “for a minimum rental of one dollar (\$1) a year, to a person, firm, or corporation real property that belongs to the school district if the instrument by which this property is let requires the lessee therein to construct on the demised premises, or provide for the construction thereon of, a building or buildings for the use of the school district during the term of the lease, and provides that title to that building shall vest in the school district at the expiration of that term.”<sup>14</sup> Section 17406 requires a “competitive solicitation process to the proposer providing the best value to the school district.” The Code defines best value based on an “objective criteria for evaluating the qualifications of proposers with the resulting selection representing the best combination of price and qualifications.” This of course differs from the requirement of the Public Contracting Code to award the project to the lowest responsible bidder who submits a responsive bid.<sup>15</sup>

The California Education Code on LLB is quite prescriptive. It requires a lease document, also referred to as the “Site Lease,” from the school district to the private entity, which typically is a single-purpose entity organized to specifically build and deliver the school project in question. This is the first document that the Code refers to for a minimum rental amount of \$1 per year. This Site Lease simply defines the property, the landlord (school district), the tenant (single-purpose entity), the rent (typically \$1 per year), and the term, which cannot exceed 40 years.<sup>16</sup> This Site Lease must also vest title in the school district at the expiration of its term.<sup>17</sup>

The second document in the LLB methodology is the “Sublease or Master Lease.” The Sublease, aside from similar provisions of the Site Lease, is the document that leases back the property to the school district with the completed school project on the site. The Sublease also defines the maximum guaranteed price for the project, and the lease payments to fully pay the cost of the project over the course of the term, not to exceed 40 years.<sup>18</sup>

The third document in the LLB transaction is the “Construction Services Agreement or Development Agreement,” which is entered into between the single-

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<sup>13</sup> California Education Code—EDC Title 1 General Education Code Provisions [1. - 32500] (Title 1 enacted by Stats. 1976, Ch. 1010.) Division 1 General Education Code Provisions [1. - 32500] (Division 1 enacted by Stats. 1976, Ch. 1010.) Part 10.5. School Facilities [17210–17653] (Part 10.5 repealed (by Sec. 4) and added by Stats. 1996, Ch. 277, Sec. 3.) Chapter 4. Property: Sale, Lease, Exchange [17385–17561] (Chapter 4 added by Stats. 1996, Ch. 277, Sec. 3.)

<sup>14</sup> Education Code Section 17406.

<sup>15</sup> Public Contracting Code Sections (20161 and 20162).

<sup>16</sup> Education Code Section 17403.

<sup>17</sup> Education Code Section 17406.

<sup>18</sup> Education Code Section 17403.

purpose entity and the designers, engineers, and builders. This Construction Services Agreement binds the entire development team to construct the school project according to plans and specifications approved by the school district, and in California, the State Architect's Office.<sup>19</sup> The Construction Services Agreement in California provides for prevailing wages to be paid in accordance with the California Labor Code.<sup>20</sup> As a public works project, the Construction Services Agreement, among other legal requirements, also includes requirements regarding the payment of bonds used to finance the project, compliance with seismic specifications, indemnifications, use of payment and performance bonds, and insurance. In some municipalities, especially in California, a project labor agreement may also be required to satisfy collective bargaining laws.

The Code permits LLBs to be financed by bonds, notes, warrants, or "other evidences of indebtedness." The interest on these financial instruments is exempt from all taxation except from inheritance, gift, or franchise taxes.<sup>21</sup> Depending on the credit quality of the school district, these bonds can be very attractive in terms of rates and conditions. The final technical piece in the methodology is an "in rem" legal action to validate the transaction. The California Code of Civil Procedure authorizes a civil action by the school district or any interested party to validate the actions of the school district. This action, filed in the trial courts of the state, validates conclusively the LLB transaction and all documentation used to document the transaction, against any persons or litigants, who might challenge it.<sup>22</sup> The California Government Code is the broadest authorization for validation actions, and it allows a plaintiff to bring a validation action to determine the validity of any local agency's bonds, warrants, contracts, obligations, or "evidences of indebtedness."<sup>23</sup> Given LLBs are performance-based initiatives, all up-front costs are the responsibility of the private sector. No payment is due from the school district on the sublease until the project is completely delivered to the school district for occupancy.

### ***Case Study: The Oxnard Fire Station 8***

Building schools under the prescription of the Education Code is well-established in California. Other social infrastructures, however, are not as well-recognized. One innovative example of an LLB social infrastructure project is Oxnard Fire Station 8, in Oxnard, California. Perhaps among the most advanced fire stations in the state, Oxnard Fire Station 8, the first of its kind using this methodology, was built and

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<sup>19</sup> Education Code Section 17406(b)(1).

<sup>20</sup> Labor Code Section 1720 et seq.

<sup>21</sup> Education Code Sections 17419 and 17420.

<sup>22</sup> Code of Civil Procedure Sections 860–870—<http://www.dailybreeze.com/2013/08/15/torrance-unified-wins-lawsuit-challenging-no-bid-construction-contracts/>.

<sup>23</sup> Government Code Section 53511.

delivered on-time and on-budget.<sup>24</sup> An incredibly experienced team of professionals in collaboration with city of Oxnard leaders pioneered the LLB model for a fire station, borrowing key components from the well-established concept codified in Education Code Section 17406. Subject matter experts on both sides openly collaborated to design an efficient methodology focusing on mutual benefits. The entire LLB transaction was carefully and transparently structured from its inception.

### *The Site Lease*

Oxnard Fire Station 8 is designed as a 13,956-square-foot fire station and training complex constructed on city-owned property. Oxnard Fire Station 8, including its associated training building, occupies approximately 2.46 acres of a larger 70-acre site. These 2.46 acres are leased under a Site Lease to Oxnard Fire Station, LLC (OFS), a single-purpose entity fully owned by a non-profit organization. At the time of the transaction, OFS had no operating history, no historical earnings, and no assets or liabilities other than the bonds sold and borrowed to finance Oxnard Fire Station 8. OFS' sole member, however, is an experienced property management nonprofit specifically qualified to "lessen the burdens of government" with a portfolio of approximately \$1 billion in real estate assets under management. The Site Lease is \$1 dollar per year for 15 years, which is tied to a city revenue stream known as measure O. Measure O is a half-cent sales tax previously approved by the voters to finance city infrastructures in general. At the end of the 15 years, OFS will dissolve, and title will vest fully onto the City of Oxnard (Fig. 2.6). While a specific revenue stream like Measure O in Oxnard is not necessary for the LLB, it is helpful in underwriting the transaction for the bond market.

One complication with a Site Lease of this type of infrastructure is the trigger of property tax obligation because the tenant is a non-governmental organization. California has dealt with this issue in the Revenue and Taxation Code.<sup>25</sup> A claim for organizational clearance for a "Welfare Exemption" is filed with the Board of Equalization. The Board on a case-by-case basis reviews these claims to determine compliance with the Revenue and Taxation Code's welfare or public purpose requirements.<sup>26</sup> Once the requirements are met, the certificate is issued for the assessor and/or tax collector of the county in which the property is located to exempt the property from the collection of property tax. The Site Lease for Oxnard Fire Station 8 is exempt from property taxation for the duration of its lease term.

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<sup>24</sup> (a) <http://archive.vcstar.com/news/local/oxnard/oxnards-new-fire-station-8-open-for-tours-thursday-at-formal-unveiling-ep-1246424339-351143351.html>.

(b) <http://www.bernards.com/portfolio/civic/oxnard-fire-station-8/>.

(c) <http://hmcarchitects.com/solutions/civic/oxnard-fire-station-no-8/>.

<sup>25</sup> Revenue and Taxation Code Section 254.6.

<sup>26</sup> Revenue and Taxation Code Section 214.

### *The Sub or Master Lease*

The Master Lease is between OFS, as the lessor, and the City of Oxnard as the lessee. The amenities and improvements under the Master Lease include the following: (a) four emergency vehicle apparatus bays; (b) ten dormitory living quarters with individual, private restrooms; (c) public lobby and ADA compliant public restroom; (d) administrative offices; (e) public lobby area; (f) firemen day room, kitchen, and dining facilities; (g) physical fitness gym; (h) paramedic emergency medical supply unit; (i) workshop, hose storage, oxygen supply, “Turn-Out” and storage rooms; (j) ancillary building equipment and support spaces; (k) naturally ventilated and daylighted apparatus bays; and (l) conference and library room. In short, it is a fully built out and turnkey fire station in the city of Oxnard (Fig. 2.5).

The Master Lease is for 15 years with an option to purchase. Title of the fire station will vest onto the City of Oxnard at the end of the 15-year term (2031) free and clear or sooner if the City of Oxnard elects to purchase the balance of the Master Lease obligation. According to the Master Lease, the City is required, subject to its abatement rights, to pay “Base Rental” and “Additional Rental” of any taxes, assessments, and insurance premiums with respect to the Oxnard Fire Station and the fees, costs, and expenses incurred by OFS for developing and financing the project (collectively “Rental”). Rental payments are payable five business days prior to each June 1 and December 1, commencing on the “Commencement Date,” which is defined in the Master Lease to mean the date upon which the certificate of occupancy is issued with respect to Oxnard Fire Station 8. Rental payments are subject to abatement during any period in which, by reason of material damage, destruction, or failure of any warranted condition, there is substantial interference with the City’s



**Fig. 2.5** Oxnard Fire Station 8 (Source for picture HMC Architects. Used with permission from HMC)

right to use and occupy Oxnard Fire Station 8 or any portion thereof. These provisions protect the city in case of a private sector failure.

Under the Master Lease, at all times following the Commencement Date, the City is required to maintain rental interruption insurance covering a period of 24 months, in an amount equal to two times the maximum annual Rental payments. In addition, Oxnard Fire Station 8 is insured, through insurers meeting certain requirements set forth in the Master Lease, against loss or damage. Any net insurance proceeds and condemnation awards are agreed to be applied to repair or replace Oxnard Fire Station 8 or to redeem all or a portion of the Bonds. The City has covenanted in the Master Lease to take such action as may be necessary to include and maintain all Rental payments due under the Master Lease in its annual budget and to make the necessary annual appropriations for all such payments. All Base Rental payments are pledged by OFS to pay off the bonds. OFS, in return for a small pre-determined fee, manages and properly maintains the structures of the building as a lessor (landlord) for the duration of the Master Lease. These provisions protect the investors in case of public sector failure.

### ***The Construction Services or Development Agreement***

The Development Agreement is between OFS (the nonprofit) and a team of private sector organizations as the developer, designer, engineer, builder, and special-related-service professionals. Under the Development Agreement, the developer is obligated to cause all service providers (e.g., designers and builders) to perform services necessary to achieve the completion of Oxnard Fire Station 8 within 24 months from the delivery date of the bonds necessary to finance the project. While all legal requirements are spelled out in this Agreement, the most important provision that is particular to the LBB methodology is the guaranteed maximum price also known as the “Contract Price.” The Contract Price covers from excavation to the delivery of Oxnard Fire Station 8 with its occupancy permit. While unusual, the Development Agreement in Oxnard also required the developer to procure all machinery, equipment (including fire trucks), and other furnishings (beds, televisions) and fixtures (hoses) related to the operation, maintenance, and administration of the fire station.

### ***The Bonds and the Loan Agreement***

The Bonds to finance the entire project were issued by the California Municipal Finance Authority (“Authority”), which loaned all of the proceeds to OFS, under a “Loan Agreement,” for the purpose of financing the design, construction, and equipping of a “turnkey” fire station in the City of Oxnard. The Loan Agreement also funded 24 months of capitalized interest on the Bonds and initial debt service on the

bonds until the commencement of the Master Lease, which provides for the payment of Base Rental as discussed in the previous section. The Bonds are issued according to the provisions of the Joint Exercise Powers Act in California, which enables the Authority to issue bonds based on the credit rating of the member municipality.<sup>27</sup>

The Bonds are limited obligations of the Authority, payable solely from and secured by the pledge of revenues (Base Rental). Neither the Authority, its members, the State, nor any of its political subdivisions are directly, indirectly, or contingently obligated to use any other moneys or assets to pay all or any portion of the debt service due on the Bonds, to levy or to pledge any form of taxation whatsoever, or to make any appropriation for their payment. The Authority has no taxing power. OFS as the Borrower executed and delivered a Leasehold Deed of Trust, Assignment of Rents and Leases, and a Security Agreement and Fixture Filing, for the benefit of a designated trustee, as trustee for the owners of the Bonds. In other words, the loan to OFS is solely secured by the Master Lease revenue or the Base Rental.

Finally, these Bonds to design and build a public fire station are tax exempt under federal income tax law. While the credit rating of the City of Oxnard was used to issue these Bonds, the underwriting of the Bonds was based on the City's ability to pay the Base Rental, which is necessary to retire the Bonds. These Bonds, unlike General Obligation Bonds, did not require the vote of the people of Oxnard for issuance. Technically, the obligation on the Bonds is that of OFS', and the City of Oxnard is simply the lessee with an obligation to make Rental payments. The City in its financial statements simply records this transaction as any other lease that the City may enter into for the necessary use of public facilities (Fig. 2.6).

### ***The PPP Concession Model—Long Beach Courthouse***

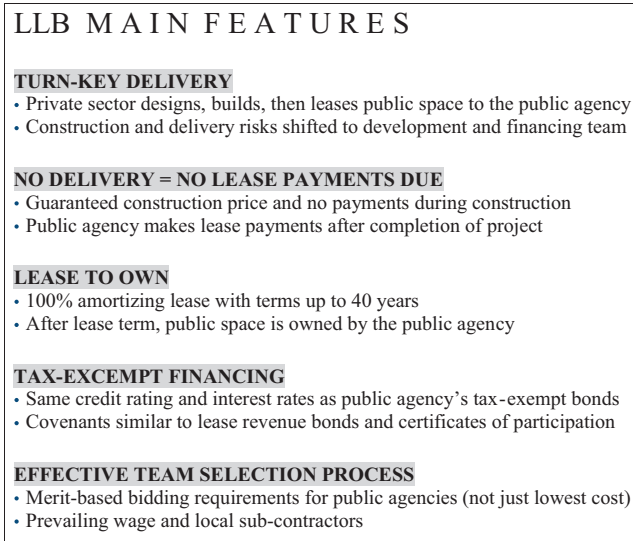
The PPP concession model is the most used and studied PPP methodology of all time. Most of the available literature on the topic describes this methodology especially for economic infrastructures going back to the fifteenth century. The French nobleman Luis de Bernam was granted a river concession on the Rhine in 1438. The Perrier brothers operated a water distribution concession in 1792. It was not until the 1970s that the methodology became part of the market-oriented economy especially in transportation projects as in toll roads.<sup>28</sup> Today, we experience the expansion of the methodology into both economic as well as social infrastructures. The Long Beach Courthouse is the first social infrastructure of its kind using the methodology in California.

In June of 2007, the Administrative Offices of the Courts (AOC), which is the staff agency for the Judicial Council of California, chaired by the Chief Justice of the California Supreme Court, completed its review of a potential project to replace the then existing and dangerously dilapidated Long Beach Courthouse. The AOC

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<sup>27</sup> Government Code Sections 6500 et seq.

<sup>28</sup> [http://ppp4krakow.net/About\\_PPP/Definition,\\_origin\\_and\\_evolution/](http://ppp4krakow.net/About_PPP/Definition,_origin_and_evolution/)



**Fig. 2.6** LLB main features

recommended the construction of a new courthouse. As part of the review, the AOC also considered alternative project delivery methods and developed a proposal to construct the courthouse utilizing the concession model of PPP. While Governor Schwarzenegger was supportive of this PBI methodology, no legal structure existed empowering the State of California to consider this procurement method.

Through language in the Budget Act of 2007, the Legislature directed and authorized the Judicial Council to enter into an agreement for a PBI project, subject to both notice to the Legislature as well as approval from the State's Department of Finance (DOF) that the project agreements met "established performance expectations."<sup>29</sup> The Legislature also amended the Trial Court Facilities Act<sup>30</sup> to add a process for the Judicial Council, the DOF, and the Legislature to evaluate facility proposals that included a public private partnership component.<sup>31</sup>

The AOC and the City of Long Beach reached an agreement in early 2007, whereby the AOC agreed to acquire the pre-selected site from the Redevelopment Agency (RDA) of the City, which owned the land bounded by West Broadway, Maine Avenue, West 3rd Street, and Magnolia Avenue in the City of Long Beach.<sup>32</sup>

<sup>29</sup> California Stats. 2007, ch.171.

<sup>30</sup> Government Code Sections 70301 et seq.

<sup>31</sup> Government Code, Section 70391.5, added by Statutes 2007, chapter 176.

<sup>32</sup> I was personally involved in this project starting late 2006 and in early 2007 I, on behalf of a private consortium, proposed to the RDA an Exclusive Negotiating Agreement for this site. Figure 2.7 represents our concept for the site. AOC wanted to take control, so instead I made my first presentation about the concept and the methodology to the AOC in April of 2007.



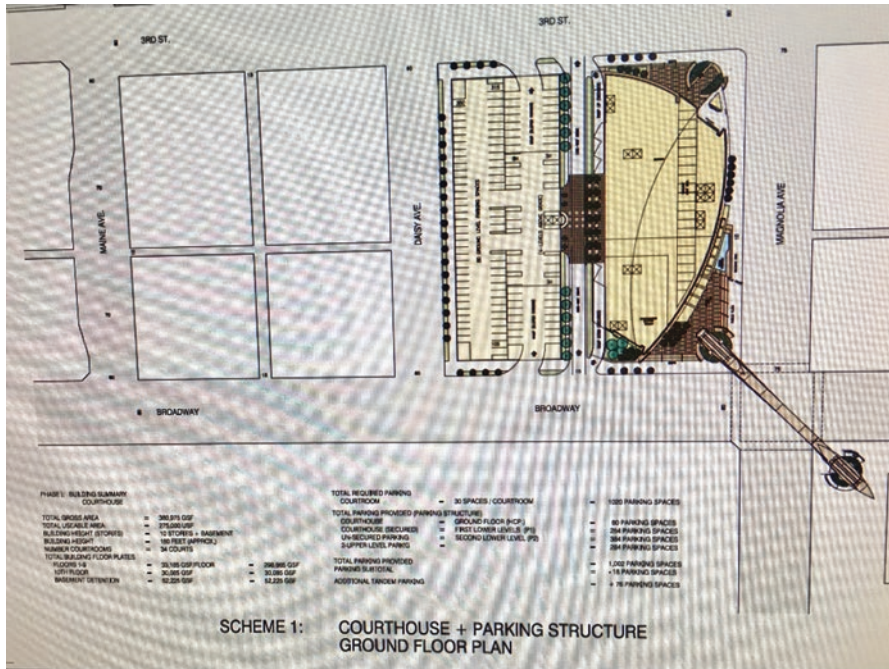


Fig. 2.7 Long beach courthouse floorplan

The site is about 6 acres, one block north from Ocean Avenue, where the former courthouse was located. After the AOC took control of the site from the RDA, it agreed to follow the PBI methodology by issuing a Request for Qualifications (RFQ) to potential proposers for the Long Beach Courthouse Project.

The AOC defined the project as a design, build, finance, operate, and maintain (DBFOM). It expected any proposer to be responsible for the design, construction, and financing of the project, including any risks associated with them. More importantly and different than any other procurement methodology, the AOC expected the proposer to be responsible for life cycle maintenance, repairs, and capital replacements to sustain the courthouse to expectations specified by the AOC. This included all interior and exterior, custodial, site maintenance, and all other operational services necessary to operate a courthouse building. For the first time in California, the maintenance and management of a public building is tied to economics. In other words, the agreement between the AOC and the proposer allows for the AOC to deduct payments if the building fails expectations outlined in that agreement. The proposer has a monetary incentive to keep the property in the condition promised for the duration of the term of the agreement, which in Long Beach Courthouse’s case is 35 years.<sup>33</sup> The people of California are at least assured a “Class A” courthouse for 35 years.

<sup>33</sup><http://www.designbulldoneright.com/long-beach-courthouse/>.

Approximately 12 proposers responded to the RFQ, from which, based on established selection criteria, the AOC interviewed 5 and short-listed 3 to request proposals (RFP). To incentivize participation to a relatively expensive RFP process, the AOC made available technical reports on the site like geotechnical, environmental, and other planning documents, along with \$500,000 to each unsuccessful RFP participant.<sup>34</sup> While this amount seems substantial, in a project of this size, responding to a detailed RFP may cost more than double the amount. However, proposers in this “league” know the losses and the rewards of their participation. At the AOC, the RFPs were evaluated based on cost, quality, and appropriateness of design, performance potential, and financial strength of the proposer to name a few important criteria. Both the process and the outcome in building a quality courthouse named after California Governor George Deukmejian served the needs of the AOC and the state of California.<sup>35</sup> While the price tag of \$490 million seemed high for some observers (over \$1100 per square foot),<sup>36</sup> 31 courtrooms, 100,000 square feet of office space leased to Los Angeles County Agencies, and more than 10,000 square feet of supporting retail uses serve more than 4000 visitors per day.<sup>37</sup>

## Conclusion

The 2017 report card issued by the ASCE still grades our national infrastructure at a D+. This is the grade that the same infrastructure earned in 2013.<sup>38</sup> Not much progress to report in 4 years. The infrastructure challenge before governments seems overwhelming. The economic booms and busts along with the lack of political will have created significant deficits in the USA and around the world. Slowly but surely, at least out of necessity, governments are realizing that inaction is not an option. While PPPs are not a panacea, they are a very important tool for governments to have and use with careful application. As discussed in this chapter, PPPs are collaborative intersectoral processes. Participants to these collaborations work to redistribute power and control from a central authority to many vested individuals and groups. This sharing of power leads to innovation, cooperation, coordination, and partnership on a higher level than is possible in a typical hierarchical system. Each sector participating to the collaboration has a different challenge and motivation. Therefore, PPP policies, rules, and laws must be tailored to the specific needs of each participating sector. Properly incentivizing each sector is key for the success of this infrastructure development tool.

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<sup>34</sup> <http://www.courts.ca.gov/documents/newlbcourt-rfq2.pdf?1511988880319>.

<sup>35</sup> <https://www.lacourt.org/courthouse/info/LB> (note from the author. Well-deserved honor for Governor Deukmejian, a friend and a personal mentor of mine.)

<sup>36</sup> <http://www.presstelegram.com/2016/05/28/judges-say-high-cost-of-long-beach-courthouse-is-depriving-other-areas-of-courtrooms/>.

<sup>37</sup> <http://www.designbulldoneright.com/long-beach-courthouse/>.

<sup>38</sup> See footnote 2.

Governments must welcome these collaborations by creating clear rules and key attributes also defined in “good governance” such as transparency, efficiency, effectiveness, participation, accountability, and results. Learning from successes and past failures, instead of retreating from the challenges, governments must use these alternative methodologies to maximize their potential to meet their infrastructure objectives. In this endeavor, governments must define their goals and objectives to develop the legal framework and processes to qualify partners in the private sector. As in California’s Long Beach Courthouse example, establishing the necessary legislative and regulatory framework for PPPs might be necessary to ensure implementation. Starting 2018, governments worldwide will compete to attract private capital. In fact, in the USA, infrastructure finance and development may be the only bipartisan issue on the political agenda before the 2018 elections. A poor legislative and regulatory environment will stymie any government’s efforts to engage the private sector.

Finally, the role of relationships and trust in organizational and/or individual leadership is not to be underestimated in designing and implementing a successful PPP. We would not have been successful in our design and delivery of Oxnard Fire Station 8 if we did not forge a relationship with all participants and did not align the interests of all participants, taking the longer view for all negotiations in life cycle considerations of the project. Interest-based and integrative negotiations for PPPs are keys to their success. I discuss this concept in greater detail in our book “Newgotiation for Public Leaders Duzert and Zerunyan 2019.” After all, the Oxnard collaboration is designed to be successful for all participants for at least 15 years. It is a well-designed PPP aligning a shared vision followed by shared and achievable goals throughout the life cycle of the project. This alignment does not occur on its own. At every stage of the process, from the initiation of the procurement through the implementation phase, government officials must protect the public interest through core values. Public and private sectors together must work through important issues, such as cost-to-benefit analysis, access to services, fairness and equity, conflicts of interest, financial accountability, stability, and quality. Working through these issues, together, guarantees the longevity of the relationship building the trust necessary to forge the long-term partnership. True and meaningful “partnership” is the most important concept in the methodology known as PPP

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