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Transforming Federal Property Management: A Case for Public-Private Partnerships

Financial Management Series

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IBM Center for
The Business of Government

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FOREWORD

On behalf of the IBM Center for The Business of Government, we are pleased to present this report, "Transforming Federal Property Management: A Case for Public-Private Partnerships," by Judith Grant Long.

Albert Morales

The federal government is by far the largest landlord in the United States, with a portfolio of land and buildings worth an estimated $328 billion. While state and local governments have made use of public-private partnerships (PPPs) as a property management tool for decades, most federal agencies are restricted from entering into such partnerships.

Public-private partnerships encompass many degrees of partnership. In the context of real estate development, PPPs refer specifically to development projects undertaken jointly by public and private entities in which there is significant and direct financial participation by both the public and private sectors.

Joel McGlynn

Property managers at all levels of government are now targeting PPPs as a means to leverage public buildings and real property to generate private investment and long-term public revenues. The increased use of PPPs at the federal level has the potential to bring about more efficient management of the federal property portfolio. For public partners facing an ongoing shortage of public capital, PPPs are a potentially attractive alternative to current practices.

Professor Long's report considers the potential for public-private partnerships as a response to federal property management issues. She focuses on the major property-related issues and assesses how public-private partnerships might be used to resolve problems such as excess and underutilized property, deteriorating facilities, and reliance on costly leasing. All these issues pose significant challenges to federal property management. The use of PPPs has the potential to effectively respond to these challenges. The report also presents a series of recommendations to successfully implement PPPs in the federal government.

We hope that this timely and informative report will be useful to public executives who want to better understand PPPs and consider them as part of their portfolio of approaches to managing the nation's property.

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Toward a New Vision of Federal Property Management

A Case for Public-Private Partnerships

Property managers at all levels of government are targeting public-private partnerships (PPPs) as a means of leveraging public buildings and real property to generate private investment and long-term public revenues. For federal property managers facing a critical and ongoing shortage of public funds, it is imperative to consider creative financing solutions, such as public-private partnerships that can attract private capital for public property purposes.

While state and local governments have utilized public-private partnerships as a property management tool for decades, most federal agencies are restricted by current regulations from entering into such partnerships. Recent efforts to extend the authority for PPPs for real property, even in limited pilot projects, have met with resistance.[1] In large part, this resistance can be attributed to a lack of understanding of PPPs in general, in combination with an accurate perception of significant implementation issues.

The purpose of this report is twofold. First, it is a primer on public-private partnerships for real estate development, intended for federal property managers, drawing mainly on the more extensive experience of state and local governments. Second, it assesses the case for PPPs as a property management tool in the context of federal agencies, examining the primary implementation issues, and recommends areas for further study.

The report draws upon other research prepared for the IBM Center for The Business of Government addressing emerging issues in property management, as well as the potential of partnerships more broadly. Stanton (2003) provides an excellent overview of federal asset management and the particular challenges of the real property portfolio. Klitgaard and Treverton (2003), considering partnerships in the context of providing federal goods and services more generally, lay a framework for evaluating when public-private partnerships should be sought and what kinds of partnerships should be forged or encouraged. Williams (2003) examines public-private partnerships as an alternative to the traditional competitive bidding process using the case

Challenges in Managing Federal Real Property

1. The federal government has excess and underutilized property.
2. Federal facilities are deteriorating.
3. The federal government has unreliable property data.
4. The federal government relies heavily on costly leasing.
5. Federal government buildings require high security standards.
6. Federal agencies lack legislative authority to enter into public-private partnerships.
7. Federal government budget scoring rules are a disincentive to public-private partnerships.
8. The federal government lacks guidelines to select federal properties suitable for public-private partnerships.
9. The federal government lacks guidelines to evaluate public-private partnership deals.

What Remains to Be Done: Managing Federal Real Property

After fully implementing the executive order on real property reform and related President's Management Agenda initiatives, agencies will need to show significant progress toward eliminating the problems that led to this area's designation as high risk, such as reducing inventories of facilities to a minimum and making headway in addressing the repair backlog. In addition, the Office of Management and Budget and agencies, through the Federal Real Property Council, will need to focus on developing strategies to address deep-rooted obstacles to a successful transformation, such as competing stakeholder interests.

Source: *Government Accountability Office,* High-Risk Series: An Update *(GAO-07-310).*

of federal procurement of civil infrastructure. Kamensky and Burlin (2005) include these and other works in a collection on collaboration and the use of networks and partnerships.

In addition to this work sponsored by IBM, the Government Accountability Office (GAO) has issued numerous reports on federal real property, several of which highlight the potential and challenges of public-private partnerships. The National Research Council's Federal Facilities Council periodically issues technical reports on issues pertaining to capital asset management that address partnerships as one of a group of new asset management techniques that could be introduced to improve facility management. Finally, much of what we know about public-private partnerships for real property originates in the study of best practices at the state and local levels of government, discussed most comprehensively in works by Sagalyn (in Miles, 2000), Stainback (2000), and Witherspoon (1982).

An Overview of the Federal Real Property Portfolio

The federal government is by far the largest landlord in the United States, with a portfolio of land and buildings worth an estimated $328 billion. The federal government owns approximately 636 million acres of land—about one-fourth the total acreage of the United States—through over 30 agencies.

It also owns over 3 billion square feet of facility space contained in 440,000 buildings located in 30,000 installations, including military bases, office buildings, embassies, prisons, courthouses, border stations, laboratories, and park facilities. In addition, it leases another 46,000 buildings comprising almost 340 million square feet. Owned assets represent 90 percent of the total building portfolio, and leased about 10 percent.[2] Table 1 presents totals for the combined portfolio. Table 2 on page 8 presents detailed statistics on federal owned and leased property.

A few federal departments hold the majority of these assets (see Table 3 on page 9). The Department of Defense (DoD) holds approximately 60 percent, the General Services Administration (GSA) holds 10 percent, and the U.S. Postal Service (USPS) holds another 10 percent, for a total of 80 percent of this space. Three other departments—the Department of Veterans Affairs (VA), the Department of Energy (DOE), and the Department of the Interior—own or lease another 10 percent. Of buildings managed by GSA, 55 percent are government owned and the remainder are leased.

Challenges in Managing Federal Real Property

Land rich but cash poor, federal agencies face a series of mounting real property management issues, including excess and underutilized property, deteriorating facilities, unreliable property data, reliance on costly leasing, and increasing security needs. Since January 2003, GAO has designated federal real property as a "high-risk" area, implying its management is vulnerable to fraud, waste, and abuse, and calling for broad-based transformations to address major economy, efficiency, and effectiveness challenges. The primary objective of the high-risk designation is to introduce new management tools

Table 1: Portfolio Totals for Federal Owned and Leased Real Property

Total Acreage	676,712,063.9
Number of Buildings	502,811
Building Area (Sq. Ft.)	3,382,972,277

Table 2: Summary of Federal Owned and Leased Real Property

Owned Real Property	In United States	Outside United States	Owned Real Property Total
Number of Installations	32,019	509	32,528
Total Acreage	674,099,756.3	1,764,699.2	675,864,455.5
% Total Acreage	99.7%	0.3%	4,408
Number of Buildings	441,213	4,408	445,621
Building Area (Sq. Ft.)	2,974,885,045	34,277,925	3,009,162,970
% Building Area	98.9%	1.1%	100.0%
Total Acquisition Cost	$331,577,551,000	$3,130,732,000	$334,708,283,000
% Total Acquisition Cost	99.1%	0.9%	100.0%

Leased Real Property	In United States	Outside United States	Leased Real Property Total
Number of Leases	59,262	11,700	70,962
Total Acreage	842,242.2	5,366.2	847,608.4
% Total Acreage	99.4%	0.6%	100.0%
Number of Buildings	46,029	11,161	57,190
Building Area (Sq. Ft.)	339,520,657	34,288,650	373,809,307
% Building Area	90.8%	9.2%	100.0%
Annual Rental Cost	$4,588,918,241	$423,915,465	$5,012,833,706
% Annual Rental Cost	91.5%	8.5%	100.0%

Notes: *"Outside United States" means foreign countries and outlying areas of the United States. Total Acquisition Cost includes acquisition costs for structures as well as buildings and land.*

Source: *GSA Federal Real Property Profile, 2002. Does not include stewardship assets such as those owned by the Department of the Interior and the Department of Agriculture.*

providing lasting solutions that offer the potential to save billions of dollars, dramatically improve service to the American public, strengthen public confidence and trust in the performance and accountability of our national government, and ensure the ability of government to deliver on its promises.[3]

Following the high-risk designation in 2003, some progress was made in improving the management of federal real property. In February 2004, the president signed executive order 13327, requiring greater coordination and cooperation among senior property officers at all executive branch departments and agencies. A new Federal Real Property Council was established in the Office of Management and Budget (OMB), responsible for developing principles for real property management including performance measures, creating a real property database, and implementing an agency asset management planning process. On the agency front, DoD has completed another round of base closures, and the VA announced asset realignment decisions.[4]

Despite these steps, GAO renewed the designation both in 2005 and 2007, stating that the underlying conditions and related obstacles that led to the initial designation continue to exist. Remaining obstacles cited include competing stakeholder interests in real property decisions; various legal and budgeting-related disincentives to optimal, businesslike real property decisions; and the need for better capital planning among agencies.[5] According to GAO, agencies also continue to cite local interests as barriers to disposing of excess property, and agencies' limited ability to pursue ownership leads them to lease property that would be more cost-effective to own over time.

Table 3: Federal Real Property Portfolio by Agency

Agency	Owned Building Area (Sq. Ft.)	Leased Building Area (Sq. Ft.)	Total Building Area (Sq. Ft.)	% Total Building Area
Army	743,674,487	8,771,834	752,446,321	22.7%
Navy	606,539,228	9,880,588	616,419,816	18.6%
Air Force	585,469,658	3,279,314	588,748,972	17.8%
General Services Administration	195,742,524	149,111,689	344,854,213	10.4%
United States Postal Service	220,816,091	107,452,808	328,268,899	9.9%
Veterans Affairs	136,755,332	4,712,120	141,467,452	4.3%
Energy	125,875,279	697,305	126,572,584	3.8%
Interior	78,898,916	2,668,992	81,567,908	2.5%
Agriculture	46,320,208	15,207,911	61,528,119	1.9%
Justice	51,383,089	8,216,136	59,599,225	1.8%
Transportation	46,780,232	12,180,043	58,960,275	1.8%
National Aeronautics and Space Administration	44,073,865	26,212	44,100,077	1.3%
Health and Human Services	24,527,890	2,869,199	27,397,089	0.8%
Labor	15,240,903	7,514,828	22,755,731	0.7%
Corps of Engineers	13,855,958	1,190,410	15,046,368	0.5%
Treasury	9,376,012	1,994,368	11,370,380	0.3%
Defense/WHS	7,656,390	0	7,656,390	0.2%
Commerce	5,657,150	346,456	6,003,606	0.2%
Tennessee Valley Authority	4,470,727	1,337,947	5,808,674	0.2%
Environmental Protection Agency	3,338,205	384,965	3,723,170	0.1%
National Archives and Records Administration	3,462,329	193,049	3,655,378	0.1%
Government Printing Office	1,418,900	489,946	1,908,846	0.1%
Education	1,391,832	0	1,391,832	0.0%
National Science Foundation	920,510	3,320	923,830	0.0%
Federal Emergency Management Agency	763,259	0	763,259	0.0%
Smithsonian	0	703,245	703,245	0.0%
Independent Government Offices	137,449	234,075	371,524	0.0%
State	235,403	0	235,403	0.0%
Federal Communications Commission	103,219	39,897	143,116	0.0%
American Battle Monuments Commission	0	14,000	14,000	0.0%
Total	**2,974,885,045**	**339,520,657**	**3,314,405,702**	**100.0%**
Percent of Total Building Area	**89.8%**	**10.2%**	**100.0%**	**100.0%**

Source: *GSA Federal Real Property Profile, 2002. Does not include stewardship assets such as those owned by the Department of the Interior and the Department of Agriculture.*

Challenge 1: The Federal Government Has Excess and Underutilized Property

The federal government has many real property and building assets it no longer needs. These excess and underutilized properties present significant costs, mainly costly maintenance, but also in terms of the opportunity costs associated with sub-optimal capital allocation and, in highly visible locations, the public perception of waste and inefficiency.[6]

According to GAO, the federal portfolio still largely reflects the business model and technological environment of the 1950s, whereas its needs have changed dramatically. During the 1990s in particular, personnel reductions, combined with changes in agency missions, and the advent of e-government have reduced the need for facility space—mainly general office space—while increasing the demand for special kinds of space, particularly those meeting new trends in information technology. The impact of these changes on real property needs during the 21st century will be significant.[7]

The major property-holding agencies, not surprisingly, also hold the largest amounts of excess and underutilized assets. For example, even after five rounds of base closures, the Department of Defense still has far more property than it needs. The Department of Veterans Affairs is struggling to reduce its large inventory of buildings as it shifts emphasis to providing outpatient services. The Department of Energy, even though it no longer produces nuclear weapons, is still maintaining an infrastructure designed for this purpose.[8]

While there is no overall estimate of how much federal property can be classified as excess and underutilized, some major property-holding agencies have taken the following actions:[9]

- **DoD:** Has already reduced its total property holdings by 21 percent over the first four rounds of base closures. Fifth round completed in 2005.
- **VA:** Over 5 million square feet already declared vacant, most in major urban areas, in 30 different buildings.
- **GSA:** Has "many buildings" that are not financially self-sustaining and/or for which there is not a substantial, long-term federal purpose.
- **DOE:** Has identified 1,200 excess facilities totaling 16 million square feet. Challenges to disposition include substantial cleanup costs and isolated locations.
- **USPS:** Studies of excess property is a major management issue, although no estimates provided.
- **State:** Has identified 92 properties as excess, worth an estimated $180 million, most of which are embassies and related facilities held overseas.

Unfortunately, due to the lack of good real property data and a systematic approach to the identification of these excess and/or underutilized assets, there is no estimate of exactly how many assets fall into this category.

Challenge 2: Federal Facilities Are Deteriorating

Given the massive size of the federal property portfolio, it is not surprising that there are significant costs associated with its maintenance, repair, and, in some cases, restoration. The tendency to defer maintenance expenses to shift expenditures for more urgent agency mission issues, combined with a shortage of capital funding in general, results in a tremendous backlog of necessary maintenance and repair work. Current estimates are at tens of billions of dollars to restore these assets and make them functional.[10] The aging of the federal building portfolio has exacerbated the deferred maintenance problem—most of the federal portfolio was built 50 years ago—and means that the repair problem is becoming more pronounced over time.

Again, the major property holding agencies are facing the most significant deferred maintenance issues. DoD, for example, estimated in 2001 that the cost of bringing its facilities to a minimally acceptable condition at $62 billion and the cost of correcting all deficiencies at $164 billion.[11] Similarly, the Department of the Interior reported a $8 billion backlog of repairs in 2002, affecting many national historic resources held by the National Park Service (NPS).[12] GSA reported a $5.7 billion maintenance backlog in 2000, estimating that 50 percent of their 1,700 buildings needed repairs totaling $4 billion.[13] The National Research Council (NRC) conducted a study of deteriorating facilities, concluding that almost all agencies across the federal government are facing this particular real property challenge.[14]

Challenge 3: The Federal Government Has Unreliable Property Data

The lack of reliable and useful real property data further compounds the management problems of excess and deteriorating assets, impeding effective and strategic decision making. GSA maintains a worldwide inventory of the federal real property portfolio that is the only central source of descriptive data—including property type, address, square footage, and acquisition date. However, since GSA relies on agency data to compile the list, it acknowledges that the worldwide inventory contains data that are unreliable and of limited usefulness.[15]

Many agencies have difficulty assembling their own property data and assessing the value of their assets and, consequently, do not report real property data on an annual basis. In FY2000, for example, only 12 of 31 agencies reported. When reported, the data may not be up to date, or will be missing key information such as how space is used, how much is used/rented, as well as the condition, age, historic significance, and security.

Real property data issues also render many federal financial documents relating to real property unreliable.[16] The state of the federal real property database is considered a "material weakness":[17]

- Hampering the government's ability to accurately report a significant portion of its assets, liabilities, and costs
- Affecting government's ability to accurately measure the full costs and financial performance of certain programs and effectively manage related operations
- Impairing government's ability to adequately safeguard certain significant assets and record various transactions

It is critical that high-quality government-wide and agency-specific data be assembled and made available, allowing decision makers to address the real property management issues highlighted in the high-risk designation.

Challenge 4: The Federal Government Relies Heavily on Costly Leasing

To meet agency property needs, the most cost-efficient method of acquisition is generally construction or purchase. However, acquisition by either of these methods requires a significant amount of capital, paid upfront. In contrast, alternatives such as lease-purchases—where payments are spread out over time and ownership of the asset is transferred at the end of the period—are generally more expensive than construction or purchase, but can be less expensive than conventional operating leases. Conventional leases—in which periodic payments are made over the specified length of the lease, with no transfer of ownership— is the most expensive way to procure federal facility space and yet, by necessity, has become the preferred procurement method in an era of reduced capital funding.[18]

Budget scoring rules, in combination with a generally tight supply of public capital, are to blame for this costly trend. According to current budget scoring rules (pursuant to the Budget Enforcement Act of 1990), the budget authority to meet the government's real property needs is to be "scored" or recorded in the budget in an amount equal to the total of the government's legal commitment over the entire life of the lease.[19] Under current budget scoring rules, a purchase is recorded in its entirety in the first year. For a lease-purchase, the net present value of the payments over the life of the lease is recorded in its entirety in the first year. For a conventional operating lease, where there is a cancellation clause and the source of federal funds is self-insured, only the annual lease payment has to be recorded in the first year, with subsequent annual payments recorded in subsequent years. Thus, conventional operating leases—in which periodic payments are made over the specified length of the lease—have become an attractive option in part because they generally look cheaper in any given year.[20]

Among agencies, GSA is the primary holder of leased space, and has become more dependent on conventional leasing over the past decade because it lacks funds to pursue ownership. In 1995, it was reported that GSA entered into 55 operating leases for long-term needs that were estimated to cost $700 million more than construction.[21] Even lease-purchase is more cost-effective when outright purchase is not an option, but conventional leasing remains more attractive because of its lower annual costs, since the value of the transfer of the asset is not built into the lease price. Besides GSA, the State Department and the VA also face an over-reliance on costly leasing.[22]

Challenge 5: Federal Government Buildings Require High Security Standards

Securing federal properties, personnel, and the visiting public against terrorist attack is an overarching property management concern. While minimum security standards have been in place since 1995 following the Oklahoma City bombing, efforts to heighten security in federal properties are intensifying following the attacks on the World Trade Center and the Pentagon on September 11, 2001.[23]

Since the cost of increasing security at all federal properties is prohibitive, efforts are under way to encourage agencies to identify their most important and vulnerable assets in order to focus spending. Important questions remain regarding the level of security necessary to adequately protect federal facilities.

Challenge 6: Federal Agencies Lack Legislative Authority to Enter into Public-Private Partnerships

Currently only the U.S. Postal Service has the authority to enter into public-private partnerships, but since it is a quasi-public agency operating at arm's length from the federal government, it is not a perfect model for federal agencies. In addition, DoD and the VA have the authority to enter into partnerships using a typological variation referred to as "enhanced-use leasing" (EUL). In EUL, the new development must contribute to the agency's core mission—namely, services to veterans or national defense. No other agencies have such legislative authority.

Challenge 7: Federal Government Budget Scoring Rules Are a Disincentive to Public-Private Partnerships

Much of the debate surrounding public-private partnerships in the federal context has to do with budget scoring rules. In effect, the current rules dictate that all new acquisition and major renovations are scored in terms of their total cost upfront measured in present value. This means that PPPs are scored exactly the same as traditional purchase or lease-purchase acquisition methods, creating a significant disincentive for their use, regardless of the cash flow implications.

Challenge 8: The Federal Government Lacks Guidelines to Select Federal Properties Suitable for Public-Private Partnerships

Selecting properties suitable for PPPs is a tremendous challenge in the federal context, where data is generally inadequate for the task of choosing candidate properties from within the entire portfolio. Ideally, properties would be selected based on both their suitability for facility needs, as well as their desirability for private market uses. Property selection would begin by examining the entire portfolio, including individual assessments and ultimately categorizations such as properties fit for disposition. Absent good portfolio data, it is almost inconceivable that meaningful decisions about property disposition can be made.

Challenge 9: The Federal Government Lacks Guidelines to Evaluate Public-Private Partnership Deals

Clarification is needed to determine what constitutes a good deal from the public sector perspective in the context of public-private partnerships. Guidelines and/or decision rules could assist with deal evaluation, including issues surrounding adequate returns for each partner and how deals should be evaluated during both the partner selection and the final deal negotiation stages.

Organization of the Report

The next section is an overview of public-private partnerships. It begins with a definition of public-private partnerships in the context of real estate development, and summarizes partnership theory and the benefits to both public and private partners. This section presents models for structuring public-private partnerships, ranging from the traditional "design/build" approach to the more contemporary "build/buy/operate." The public-private partnership process, including selection of a private partner, is discussed in detail in the Appendix.

This is followed by a section that considers the potential for public-private partnerships as a response to federal property management issues. Focusing specifically on the high-risk issues, it assesses how public-private partnerships might be utilized to resolve problems with excess and underutilized property, deteriorating facilities, and reliance on costly leasing. Implementation issues—a significant challenge to the potential of public-private partnerships in the federal property context—are discussed, specifically legislative authority, budget scoring rules, property selection, and deal evaluation.

Understanding Public-Private Partnerships for Real Estate Development

Defining Public-Private Partnerships for Real Estate Development

The rubric of public-private partnerships encompasses many degrees of partnership, from active collaboration to incidental cooperation, across a broad range of public policy topics, from healthcare to national security. In the context of real estate development, PPPs refer specifically to individual development projects undertaken jointly by public and private entities, where there is significant and direct financial participation by both the public and private sectors and where these responsibilities are formalized in a legal contract.[24]

PPPs for real estate development are a specific subset of PPPs for the provision of public services, dealing specifically with buildings and real property intended for both publicly and privately occupied residential, commercial office, and commercial industrial uses. PPPs for real estate development span a spectrum of models that progressively engage the expertise and/or capital of the private sector. At one end, there is straight contracting out as an alternative to traditionally delivered public development. At the other end, there are arrangements that are publicly administered but within a framework that allows for private finance, design, building, operation, and possibly temporary ownership of a building or real property. The term *privatization* is used in the case of full divestiture or when a specific function is turned over to the private sector and regulatory control remains a public sector responsibility.

PPPs differ from standard government procurements for public facilities in that the private sector partner usually makes a substantial at-risk equity investment in the project—in essence, taking on some of the project risk that is normally borne by the public sector alone. In exchange for taking on a share of the project risk, the private partner shares in income generated by the project. For its part, the government partner gains access to new revenue or service delivery capacity without having to pay the private sector partner. The public party may retain ownership of the facility or system, but the private party generally invests its own capital to design, develop, and operate the facility.[25] Not all PPPs provide exclusively public space; in some cases, there may be a significant private component to the project. Co-development of private market components to offset the costs of public facilities is a significant opportunity associated with PPPs.

The introduction of PPPs at the federal level is intended to bring about the more efficient management of the federal property portfolio, measured largely in financial benefits. By contrast, at the state and local level, partnerships are less about portfolio management and more about incentives to bring about targeted economic development in soft markets or down cycles. Federal PPPs would also differ from partnerships involving federal quasi-public institutional structures and corporations, such as the U.S. Postal Service, since these organizations operate with greater flexibility and fewer restrictions than federal agencies.[26]

Why Partner?

Property managers at all levels of government are targeting PPPs as a means to leverage public buildings and real property to generate private investment and long-term public revenues.[27] For public partners facing a drastic and ongoing shortage of public capital, PPPs are particularly attractive, since in effect

Glossary of Terms

Terminology established by the U.S. Government Accountability Office and the U.S. National Council for Public-Private Partnerships

Build/Operate/Transfer (BOT) or Build/Transfer/Operate (BTO)

The private partner builds a facility to the specifications agreed to by the public agency, operates the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the agency at the end of the specified period of time. In most cases, the private partner will also provide some or all of the financing for the facility, so the length of the contract or franchise must be sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public partner can assume operating responsibility for the facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner. The BTO model is similar to the BOT model, except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period.

Build-Own-Operate (BOO)

The contractor constructs and operates a facility without transferring ownership to the public sector. Legal title to the facility remains in the private sector, and there is no obligation for the public sector to purchase the facility or take title. A BOO transaction may qualify for tax-exempt status as a service contract if all Internal Revenue Code requirements are satisfied.

Buy-Build-Operate (BBO)

A BBO is a form of asset sale that includes a rehabilitation or expansion of an existing facility. The government sells the asset to the private sector entity, which then makes the improvements necessary to operate the facility in a profitable manner.

Contract Services: Operations and Maintenance

A public partner (federal, state, or local government agency or authority) contracts with a private partner to provide and/or maintain a specific service. Under the private operation and maintenance option, the public partner retains ownership and overall management of the public facility or system.

Contract Services: Operations, Maintenance & Management

A public partner (federal, state, or local government agency or authority) contracts with a private partner to operate, maintain, and manage a facility or system proving a service. Under this contract option, the public partner retains ownership of the public facility or system, but the private party may invest its own capital in the facility or system. Any private investment is carefully calculated in relation to its contributions to operational efficiencies and savings over the term of the contract. Generally, the longer the contract term, the greater the opportunity for increased private investment, because there is more time available in which to recoup any investment and earn a reasonable return. Many local governments use this contractual partnership to provide wastewater treatment services.

Design-Build (DB)

A DB is when the private partner provides both design and construction of a project to the public agency. This type of partnership can reduce time, save money, provide stronger guarantees, and allocate additional project risk to the private sector. It also reduces conflict by having a single entity responsible to the public owner for the design and construction. The public sector partner owns the assets and has the responsibility for the operation and maintenance.

Design-Build-Maintain (DBM)

A DBM is similar to a DB except the maintenance of the facility for some period of time becomes the responsibility of the private sector partner. The benefits are similar to the DB, with maintenance risk being allocated to the private sector partner and the guarantee expanded to include maintenance. The public sector partner owns and operates the assets.

Design-Build-Operate (DBO)

A single contract is awarded for the design, construction, and operation of a capital improvement. Title to the facility remains with the public sector unless the project is a design/build/operate/transfer or design/build/own/operate project. The DBO method of contracting is contrary to the separated and sequential approach ordinarily used in the United States by both the public and private sectors. This method involves one contract for design with an architect or engineer, followed by a different contract with a builder for project construction, followed by the owner's taking over the project and operating it.

A simple design-build approach creates a single point of responsibility for design and construction and can speed project completion by facilitating the overlap of the design and construction phases of the project. On a public project, the operations phase is normally handled by the public sector under a separate operations and maintenance agreement. Combining all three phases into a DBO approach maintains the continuity of private sector involvement and can facilitate private-sector financing of public projects supported by user fees generated during the operations phase.

Developer Finance

The private party finances the construction or expansion of a public facility in exchange for the right to build residential housing, commercial stores, and/or industrial facilities at the site. The private developer contributes capital and may operate the facility under the oversight of the government. The developer gains the right to use the facility and may receive future income from user fees.

While developers may in rare cases build a facility, more typically they are charged a fee or required to purchase capacity in an existing facility. This payment is used to expand or upgrade the facility. Developer financing arrangements are often called capacity credits, impact fees, or extractions. Developer financing may be voluntary or involuntary depending on the specific local circumstances.

Enhanced Use Leasing (EUL)

An EUL is an asset management program in the Department of Veterans Affairs that can include a variety of different leasing arrangements (e.g., lease/develop/operate, build/develop/operate). EULs enable the VA to long-term lease VA-controlled property to the private sector or other public entities for non-VA uses in return for receiving fair consideration (monetary or in-kind) that enhances VA's mission or programs.

Lease/Develop/Operate (LDO) or Build/Develop/Operate (BDO)

Under these partnership arrangements, the private party leases or buys an existing facility from a public agency; invests its own capital to renovate, modernize, and/or expand the facility; and then operates it under a contract with the public agency. A number of different types of municipal transit facilities have been leased and developed under LDO and BDO arrangements.

Lease-Purchase

A lease-purchase is an installment-purchase contract. Under this model, the private sector finances and builds a new facility, which it then leases to a public agency. The public agency makes scheduled lease payments to the private party. The public agency accrues equity in the facility with each payment. At the end of the lease term, the public agency owns the facility or purchases it at the cost of any remaining unpaid balance in the lease.

Under this arrangement, the facility may be operated by either the public agency or the private developer during the term of the lease. Lease-purchase arrangements have been used by the General Services Administration for building federal office buildings and by a number of states to build prisons and other correctional facilities.

Sale/Leaseback

This is a financial arrangement in which the owner of a facility sells it to another entity and subsequently leases it back from the new owner. Both public and private entities may enter into sale/leaseback arrangements for a variety of reasons. An innovative application of the sale/leaseback technique is the sale of a public facility to a public or private holding company for the purposes of limiting governmental liability under certain statutes. Under this arrangement, the government that sold the facility leases it back and continues to operate it.

Tax-Exempt Lease

A public partner finances capital assets or facilities by borrowing funds from a private investor or financial institution. The private partner generally acquires title to the asset, but then transfers it to the public partner either at the beginning or end of the lease term. The portion of the lease payment used to pay interest on the capital investment is tax exempt under state and federal laws. Tax-exempt leases have been used to finance a wide variety of capital assets, ranging from computers to telecommunication systems and municipal vehicle fleets.

Turnkey

A public agency contracts with a private investor/vendor to design and build a complete facility in accordance with specified performance standards and criteria agreed to between the agency and the vendor. The private developer commits to build the facility for a fixed price and absorbs the construction risk of meeting that price commitment. Generally, in a turnkey transaction, the private partners use fast-track construction techniques (such as design-build) and are not bound by traditional public sector procurement regulations. This combination often enables the private partner to complete the facility in significantly less time and for less cost than could be accomplished under traditional construction techniques.

In a turnkey transaction, financing and ownership of the facility can rest with either the public or private partner. For example, the public agency might provide the financing, with the attendant costs and risks. Alternatively, the private party might provide the financing capital, generally in exchange for a long-term contract to operate the facility.

they attract private capital for public purposes. Private partners, for their part, find PPPs attractive because they provide the opportunity to earn a return on private capital via profits.

Critics of PPPs decry the additional cost of substituting private capital for public, implying that there is a premium associated with the use of private capital due to the expectation of profit. While PPP advocates acknowledge the premium paid to private capital, they argue that the premium is repaid in two ways: (1) through the efficiencies of collaboration as well as (2) opportunity cost savings.

First, PPPs offer efficiencies of collaboration, whereby the increased cost of using private capital is repaid through the reduced project costs resulting from the private partner's increased discipline and efficiency. Prevailing theory suggests that PPPs promote optimal risk allocation among partners, thereby reducing costs and increasing profits for both—in lay terms, allowing each partner to do what it does the best. The result is that the public sector can get what it wants for less money upfront, while at the same time earning profits for the private sector. Some economists argue that these efficiencies are not captured, and instead the result is the "Shaw-Duncan" effect, where partners match weaknesses instead of strengths.[28]

Second, PPPs also allow for opportunity cost savings associated with using private capital to pay for immediate and short-term portfolio needs when there is no public capital available to meet such needs. For federal facilities, the best example of opportunity cost savings is associated with the issue of deferred maintenance, where, if otherwise left untreated, will accrue further costs at an accelerated rate. Since there is a chronic shortage of public capital to pay for maintenance problems associated with government properties, there is little doubt that such problems will remain untreated.

Public-private partnerships, then, are an important alternative to the use of public capital, attracting private capital to the management of public assets. Of course, the advantages and disadvantages to each partner are more nuanced. The following sections look at PPPs from the perspective of public and private partners in more detail.

The Public Partner Perspective

For the public partner, the primary advantages of PPPs are the access to private capital and the potential for cost savings—through the efficiencies of collaboration at the project level as well as opportunity cost savings stemming from addressing deferred maintenance and/or transferring project savings to other agency

Table 4: Public Partner Perspective

Advantages	Disadvantages
Access to private capital • Reduce reliance on upfront appropriations for acquisition, renovation, maintenance • Reduce reliance on costly leasing	**Cost of private capital** • Some preferred return is paid to private partner in exchange for taking on more risk • How to determine what rate of return is sufficient, but not excessive
Project cost savings • Private sector delivers project at lower cost due to greater expertise and efficiency	**Project cost savings do not materialize** • Unforeseen complications offset other savings
Opportunity cost savings • Use of private capital now to pay for deferred maintenance results in greater savings later, since repairs accrue at accelerated rate	**Complexities of RFP as a procurement model** • Time-consuming • Can deliver unknown partner • High level of public scrutiny • Risk of lawsuits
Earn income • Public sector can negotiate to share income from the project, typically in exchange for taking back some risk that would be faced by the private developer	**Risk of undervaluing of public assets** • Who determines what properties are worth • How the value is revealed to the public

missions. There is also the potential to earn ongoing revenues, typically by further reducing one or more of the private partner's operational risks, often associated with a private market component of the project.

Importantly, PPPs offer the combination of these benefits with long-term control over the asset, a feature that can be important not only in terms of capturing long-term property value appreciation, but also significant to public property portfolio strategy where currently underutilized properties are in strategic locations for future use.

Finally, PPPs allow public partners to leverage assets to generate provision of social amenities such as parks and community centers, but this is more typically the focus of local and state governments rather than federal.[29]

Disadvantages lie primarily in the risk that anticipated cost savings do not materialize. For example, the cost of private capital may be excessive or unforeseen complications may offset savings from collaboration. Public interests in profit sharing during operations are often subordinated to other parties, with the result that the public partner may not realize any actual revenue. Selection of properties appropriate for PPPs is difficult, as is determining the value of particular properties, and if poorly done will lead to an erosion of cost savings. Cost savings also erode when the partnership process is overly long or if it delivers an unknown private partner whose subsequent withdrawal requires restarting the process.

The Private Partner Perspective

For the private partner, the main advantages of public-private partnerships lie in the opportunity to earn a return on private capital via profits. Private profit potential is increased when the public partner takes on risks typically borne by the private partner in the traditional development process. For example, if the public sector retains ownership of the land and leases it to the private partner, then the private partner is relieved of funding land acquisition, typically 10 to 15 percent of a capital budget. Also, profitability of entering into a PPP is tied to the expectation of reduced regulatory burdens, since private partners perceive public entities as more likely to expedite projects in which they have a direct investment. Moreover, the public partner may be more likely to negotiate lateral agreements with other levels of government to secure development approval.

Table 5: Private Partner Perspective

Advantages	Disadvantages
Earn profits • Construction • Operation of public facility • Operation of private uses on public site	**Profits do not materialize** • Unforeseen complications and costs offset profits
Access to new markets • New geographic markets • New project types • Areas where private uses have been prohibited	**Complexities of RFP process** • Cost of participation is high for both successful and unsuccessful bidders • High level of public scrutiny throughout process • Political cycles can derail project
Expedited approvals • Private uses accompanying public component move through some parts of the approval process more quickly	**Public sector expectations may be out of sync with market** • Land use program • Design • Public vs. private uses
High-profile projects • Source of firm advertising • Networking for future contracts	**New legislation may be required** • Revisions to existing procurement law • At federal level, only USPS and VA have permission to enter into PPPs

Other important reasons for private interest in partnerships include access to new markets, participation in high-profile projects that serve as a form of advertising, and the benefit of making valuable contacts for other types of projects. Also, when PPPs allow for private market components on federal sites, there is the potential to capture profits from locations where private development had previously been excluded.

The key disadvantage to private partners lies in the risk that expected profits do not materialize. Similar to the reasons why public partners might not realize anticipated cost savings, private partners are at risk for losses due to unforeseen complications, the difficulty of valuing public property, and the inherent complexity of the partner selection process. Often, for example, public partners have unformed or even unrealistic expectations about the nature of the proposed development, and the subsequent negotiations can be very time-consuming. Private partners must have a good understanding of government culture, be prepared to share the lead in the development with their public partner, and be aware of shifting political cycles that may potentially derail the project. Moreover, if there is no legislative authority for the public partner to enter into PPPs, then significant implementation delays should be anticipated.

Types of Partnerships

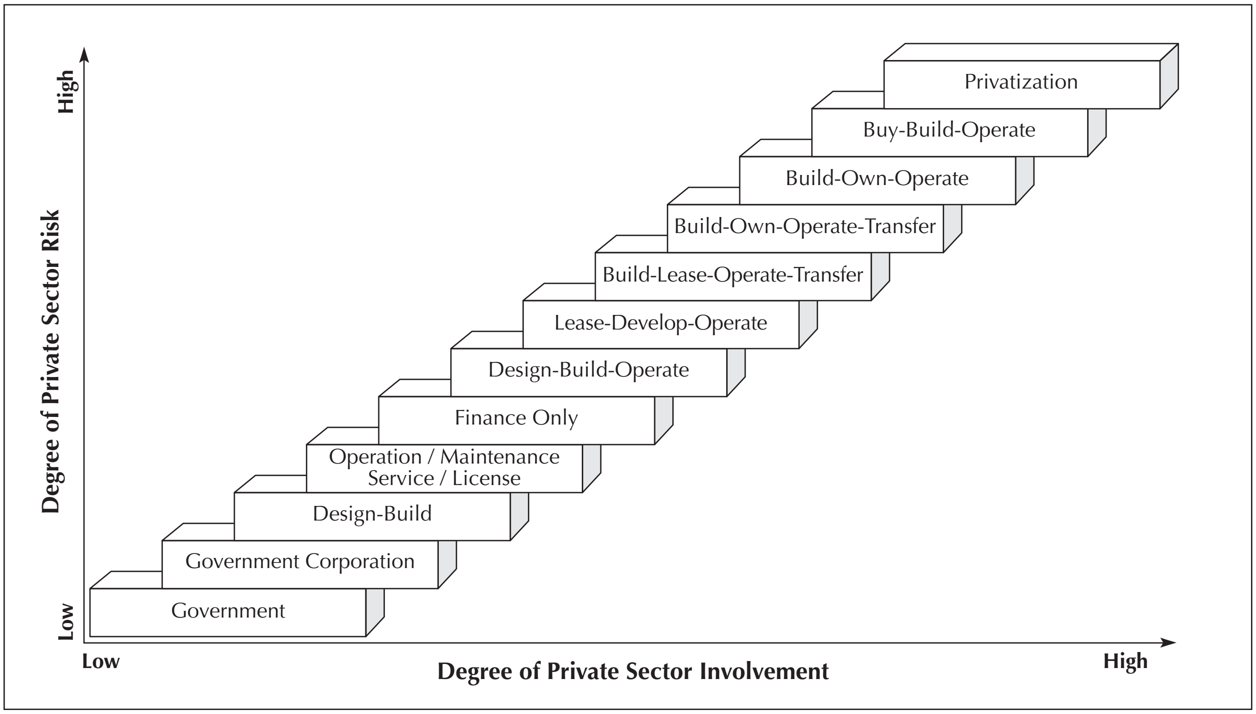
There are a variety of ways to structure public-private partnerships, differing mainly in terms of the degree of private sector involvement and the concomitant degree of private sector risk. Using a spectrum bounded on one end by pure public provision and on the other by pure private provision, the Canadian Council for Public-Private Partnerships identifies as many as 10 different partnership types (see Figure 1). The following descriptions also reflect definitions used by Williams (2003) and GAO (1999).[30]

In the traditional public development process, government entities procure new facilities by first issuing contracts to the private sector for the design of the facility and then issuing separate contracts to build. Thereafter, the government entity would operate and dispose of the asset as appropriate, all the while maintaining ownership of the asset.

Design/Build (DB)

Modifications to this highly fragmented traditional procurement model include the "Design/Build" approach, where a private contractor provides both design and construction of a project to the public agency, reducing time to completion, saving money,

Figure 1: Types of Partnership



Source: *Adapted from the Canadian Council for Public-Private Partnerships.*

and reducing conflict by having a single contractor responsible for design and construction.

Design/Build/Maintain (DBM)

A variation on DB is "Design/Build/Maintain," where maintenance of the facility for some period of time also becomes the responsibility of the private contractor. The benefits are similar to the DB, with maintenance risk being allocated to the private contractor and the guarantee expanded to include maintenance.

Design/Build/Operate (DBO)

In a "Design/Build/Operate" partnership, a single contract is awarded for the design, construction, and operation of a capital improvement. Title to the facility remains with the public sector unless the project is a design/build/operate/transfer or design/build/own/operate project.

The DBO method of contracting is contrary to the separated and sequential approach ordinarily used in the United States by both the public and private sectors. This method involves one contract for design with an architect or engineer, followed by a different contract with a builder for project construction, followed by the owner's taking over the project and operating it. A simple design-build approach creates a single point of responsibility for design and construction and can speed project completion by facilitating the overlap of the design and construction phases of the project. On a public project, the operations phase is normally handled by the public sector under a separate operations and maintenance agreement. Combining all three phases into a DBO approach maintains the continuity of private sector involvement and can facilitate private sector financing of public projects supported by user fees generated during the operations phase.

Build/Operate/Transfer or Build/Transfer/Operate (BOT, BTO)

In a "Build/Operate/Transfer" or "Build/Transfer/Operate" partnership, the private partner builds a facility to the specifications agreed to by the public agency, operates the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the agency at the end of the specified period of time. In most cases, the private partner will also provide some or all of the financing for the facility, so the length of the contract or franchise must be sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public partner can assume operating responsibility for the facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner.

The BTO model is similar to the BOT model except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period.[31]

Build/Own/Operate (BOO)

In a "Build/Own/Operate" partnership, the private partner constructs and operates the facility without transferring ownership to the public sector. Legal title to the facility remains in the private sector, and there is no obligation for the public sector to purchase the facility or take title. A BOO transaction may qualify for tax-exempt status as a service contract if all Internal Revenue Code requirements are satisfied.[32]

Buy/Build/Operate (BBO)

A "Buy/Build/Operate" partnership is a form of asset sale that includes a rehabilitation or expansion of an existing facility. The government sells the asset to the private sector entity, which then makes the improvements necessary to operate the facility in a profitable manner.[33]

Recommendations for Transforming Federal Property Management

The Potential of Public-Private Partnerships

Public-private partnerships offer potential to aid in the resolution of several federal real property issues, in particular those of excess and underutilized assets, deteriorating facilities, and reliance on costly leasing. While the implementation of public-private partnerships in the context of a portfolio management approach depends in part on the availability of good quality real property data, it is not a solution in itself. Moreover, PPPs may be a less suitable procurement model given the highly specialized nature of facilities requiring heightened security, since there may be little room to capture profits through efficiency, operation, or private uses co-located at the site.

Before PPPs can be utilized as a property management technique, several significant implementation issues must be resolved. Authority must be granted for agencies to enter into PPPs, and a pilot program for GSA should be considered to target the specific issue of costly leasing. Budget scoring rules must be adapted to allow for partnerships, and decision rules must be established to guide both the selection of properties appropriate for public-private partnerships as well as the evaluation of deals.

Recommendation 1: The Federal Government Should Use PPPs to Address the Challenge of Its Excess and Underutilized Property.

The federal government has many buildings and properties it no longer needs. Many assets reflect a business model from the 1950s, and thus are no longer effectively aligned with, or responsive to, agencies' changing missions. Yet agencies continue to hold on to excess and underutilized properties. In large part, this is a consequence of federal regulations requiring that sale proceeds be remitted to a general fund—a significant disincentive to timely disposition.

Recommendations

Recommendations Related to the Potential of Public-Private Partnerships

1. The federal government should use PPPs to address the challenge of its excess and underutilized property.
2. The federal government should use PPPs to address the challenge of deteriorating federal facilities.
3. The federal government should use PPPs to address the challenge of its reliance on costly leasing.

Recommendations Related to Implementing Public-Private Partnerships

4. The federal government should request legislative authority to enter into PPPs.
5. The federal government should revise its scoring rules.
6. The federal government should write guidelines for the selection of federal properties for PPPs.
7. The federal government should write guidelines for the evaluation of PPPs.

Consequently, sale proceeds cannot be used to fund agency missions, and taken in combination with the scarcity of public funds for new property acquisitions, agencies are holding on to properties in case they are needed in the future or as bargaining chips in negotiations for new acquisitions through land swaps or other arrangements.

The potential for public-private partnerships in the disposition of excess and underutilized assets is to allow an agency to retain long-term control of properties for future needs and to capture appreciation while earning revenues in the short term to fund the agency's mission. New development on the site could serve agency needs alone, private needs alone, or some combination of the two. Often federal properties are strategically located in urban areas and are sufficiently large to represent significant private market redevelopment opportunities. Private developers are often eager to gain access to these formerly off-limits sites and may pay a premium to do so.

Many state and local governments use PPPs as a means to redevelop strategic sites in a way that earns public revenues while also controlling land use, height, and massing, as well as leveraging social benefits from the private partner, such as the provision of transportation infrastructure, parks, and affordable housing.

The federal government is not typically portrayed as a provider of local community development benefits aside from employment. PPPs offer a model whereby such gains could be made. The federal Good Neighbor Program, for example, suggests that federal agencies consider local community and economic development corporations as partners in the redevelopment of excess and underutilized land to the extent that such local organizations could act as, or indicate, preferred private partners.

Of course, the overarching problem associated with the issue of excess and underutilized property is its identification and assessment. Most agencies do not have reliable property data, leaving little hope for reliable portfolio-wide data in the near future. As such, even though much ado is made of excess and underutilized property, it may not be advisable to establish long-term disposition policy until better data is available.

Recommendation 2: The Federal Government Should Use PPPs to Address the Challenge of Deteriorating Federal Facilities.

The widespread issue of deteriorating federal facilities due to years of deferred maintenance is the result of both the disincentives to disposition, as well as the general shortage of capital funds to maintain and repair the huge federal portfolio. Public-private partnerships offer the potential to attract private capital to the repair problem in exchange for the right to operate the property, for either public and/or private uses, over a long-term lease. Perhaps the most compelling argument for the use of PPPs to address the repair issue is the notion of opportunity cost: Repairs not undertaken now will accrue costs at an accelerated rate over time.

Of course, these significant cost savings will be offset by the reduced revenues earned over the life of the lease, since the private partner would face significant start-up costs and risks that would require compensation. However, the agency retains long-term control over the site and some ability to shape its redevelopment.

Recommendation 3: The Federal Government Should Use PPPs to Address the Challenge of Its Reliance On Costly Leasing.

Public-private partnerships are most often touted as an alternative to costly leasing, which is currently the most frequent means to acquiring new space for federal agencies, in effect substituting private upfront financing in exchange for a long-term, guaranteed public lease. As discussed earlier in the introduction to this report, short-term leases are favored by agencies mainly because of their treatment under current budget scoring rules, requiring only that the yearly lease amount be recorded, rather than the present value of the entire lease commitment in the first year of the lease. In the context of scarce public funds for acquisitions, it is very difficult for agencies to build their own space, or even to enter into a lease-purchase agreement due to these same rules.

PPPs offer a potential solution to costly leasing in that the agency could retain long-term control over the asset (similar to a lease-purchase), while avoiding the premium rates associated with short-term leasing that ultimately offer no long-term benefits. The challenge is to have the budget scoring rules adapted to accommodate PPPs such that they would be scored on the basis of their annual cost, rather than the present value of their entire cost. This issue is further discussed in following section.

The Challenge of Implementing Public-Private Partnerships at the Federal Level

The challenges to implementing PPPs as a tool for federal property management are significant, in large part due to the complexity of the federal legal and institutional context. There are numerous laws and regulations governing acquisition, management, and disposal of federal real property assets. The Federal Property and Administrative Services Act of 1949 (Property Act) is the law that generally applies to real property held by federal agencies, and GSA is responsible for the act's implementation.

Some agencies are exempt from the Property Act, including public domain assets and land reserved for national forest or national park purposes, while others have their own statutory authority pertaining to real property. For example, DoD has its own authority to outlease real property under its control for five years or longer if a determination is made that doing so will promote national defense or be in the public interest. The VA has separate authority to enter into public-private partnerships to lease its property to nongovernmental entities, and USPS is exempt from most federal laws dealing with real property and contracting.

Agencies must also comply with numerous other laws related to real property, including the Stewart B. McKinney Homeless Assistance Act requiring excess federal property to first be made available to assist the homeless, and the National Historic Preservation Act requiring agencies to manage historic properties under their control.[34]

Stakeholders in the federally owned property policy arena, besides GSA and other major federal property-holding agencies, include members of Congress, who monitor closely federal facilities located in their districts and the economic impact of any decisions. OMB plays a large role in real property decisions through capital acquisition and management policies, particularly through budget and appropriation scoring rules.

Other stakeholders include state and local governments; business interests in the communities where the assets are located; private sector construction and leasing firms; historic preservation organizations; various advocacy groups; and the public in general, which often views the facilities as the physical face of the federal government. At both the national and local levels, federal real property practices also tend to attract significant media attention, particularly when these practices are under scrutiny for waste and mismanagement.[35]

Recommendation 4: The Federal Government Should Request Legislative Authority to Enter into PPPs.

Currently only the United States Postal Service has the authority to enter into public-private partnerships, but since it is a quasi-public agency operating at arm's length from the federal government, it is not a perfect model for federal agencies. DoD and the VA have the authority to enter into "enhanced-use leasing," or EUL, a variation on public-private partnerships. In EUL, the new development must contribute to the agency's core mission, namely, services to veterans or national defense. For example, in Texas, a private developer constructed a VA regional office building on the VA's medical campus. The VA then leased the land to the developer and the developer constructed additional buildings and rented space to commercial businesses. The VA got office space at little upfront cost, and the developer repaid their capital and earned profits through rents on the private component. In this case, the lease enhanced the primary use of the site, and the VA's core mission, by providing administrative office space.[36]

There have been recent attempts to extend the authority to enter into PPPs to other federal agencies. Two bills were introduced, but not passed, in 1999–2000. The Federal Property Reform Act of 2000, S. 2805, would have amended the Federal Property and Administrative Services Act of 1949, allowing federal agencies, among other things, to out-lease underutilized portions of federal real property for 20 to 35 years and retain the proceeds from the transfer or disposition of real property. The Federal Asset Management Improvement Act of 1999, H.R. 3285, provided for partnerships with the private sector to improve and redevelop federal real property, with proceeds from these partnerships being retained for the improvement of federal property.[37] In summarizing these actions, GSA noted that while the bills did not pass, their provisions reflect the kinds of actions that could be taken to address the issues surrounding the management of federal real property.

Regulations attached to the bill would have changed budget scoring rules:

- Property must be available for lease, in whole or in part, by federal executive agencies.
- Agreements do not guarantee occupancy by the federal government.
- The government will not be liable for any actions, debts, or liabilities of any person under an agreement.
- Leasehold interests of the federal government are senior to those of any lender of the non-governmental partner.

Recommendation 5: The Federal Government Should Revise Its Scoring Rules.
Much of the debate surrounding PPPs in the federal context has to do with budget scoring rules. In effect, the current rules dictate that all new acquisition and major renovations are scored in terms of their total cost upfront measured in present value. Under these rules, PPPs would not be treated differently.

If PPPs are to be scored differently from an outright purchase or lease-purchase—on their annual cost basis, as proponents recommend—then this is a contradiction of the overarching federal budget principles, creating significant transparency and accountability issues. Clearly, advocates for PPPs have significant work to do in this arena, for without these changes, PPPs will not progress through the appropriation process.

Recommendation 6: The Federal Government Should Write Guidelines for the Selection of Federal Properties for PPPs.
Selecting properties suitable for PPPs is a tremendous challenge in the federal context, where there is insufficient data to choose properties relative to the entire portfolio. Were it possible to make assessments about portfolio-wide property needs, then the next step would be to select properties suitable for partnerships—that is, those with characteristics sought by private developers. Not surprisingly, developers are generally interested in buildings and sites in good locations, in strong markets, and centrally located. Developers are often very aware of the opportunities presented by excess and underutilized federal properties. Conflicts in the selection process undoubtedly arise for properties located in such favorable areas that they present great profit potential to a developer while, at the same time, long-term strategic value to the federal portfolio.

Filtering an agency's portfolio, or the entire federal portfolio, to identify properties suitable for PPPs is further complicated by the need for familiarity with the local market. It is not clear that regional agency offices have this expertise. The issue of property valuation is also raised—who will conduct assessments and how property values will be revealed to the public.

Recommendation 7: The Federal Government Should Write Guidelines for the Evaluation of PPPs.
What constitutes a good deal from the public sector perspective? What constitutes a good deal from the private sector perspective? How should deals be evaluated, during both the partner selection and the final deal negotiation stages? Are traditional real estate return measures such as internal rate of return (IRR) and cash-on-cash appropriate?

In 2001, GSA contracted with Ernst and Young, LLC to model the impact of partnerships on agency properties throughout the United States. The consultant developed and analyzed PPP scenarios for 10 properties, each representing different land uses and regions. A benchmark IRR of 15 percent was assumed for the purpose of attracting private sector interest, assuming a 50-year ground lease.

Intended to garner support for a pilot program authorizing PPP authority for GSA, the agency acknowledged that the study was not particularly rigorous. Nonetheless, it concluded that for seven of the 10 properties, a favorable IRR (>15 percent) was possible. This was interpreted to indicate that a private developer would be interested in developing the property, and that public benefits, primarily in the form of new agency office space, could be simultaneously achieved with little or no upfront public capital.[38]

Clearly, these results would not be replicable for individual properties given the vagaries of both individual properties and local real estate markets. Reliance on IRR as the sole indicator of private interest is likely to be misleading. More importantly, evaluation criteria ought to be carefully considered and enumerated for both public and private partners.

Conclusion

Public-private partnerships, like many other progressive property development models, are most favorable to the public when viewed in terms of their possibility, or *a priori* state. In the federal context, PPPs offer cost savings, responsive developments, and long-term control over the site. These are indeed significant benefits, and when taken in the context of the federal property management crisis, PPPs seem a model well worth exploring as part of an overall portfolio management approach. Viewed *ex ante*, however, PPPs may be less compelling, especially when taking into account the vagaries of individual deals, and thus warrant some words of caution.

PPPs may be considered part of a broader movement to make government more businesslike.[39] A comparison is often made between government portfolios and those held by major corporations, who view property assets as a critical input to their core business. It is difficult, however, to directly adapt private sector approaches to government due to its unique context. Specifically, private models are not immediately transferable without explicit recognition of the government's capabilities to implement those solutions. A good example is the disposition proceeds issue: If agencies were allowed to retain sale proceeds, it may place pressure on them to sell properties in order to fund short-term agency needs, without sufficient thought to the long-term implications for the agency property portfolio.

The effective implementation of businesslike models such as PPPs also depends upon the quality of in-house property management expertise. PPPs require federal agencies to act as property developers, understanding asset values, the request for proposals process, and, in some cases, the market for private uses to be co-located on a site. Governments are well advised to develop this expertise, since it is essential to an effective portfolio-based approach to property management and essential to adopting a broad range of other creative approaches including enhanced-use leasing and land swaps.

Appendix: The Public-Private Partnership Development Process

When government partners with the private sector to develop real estate, the process differs from both the conventional private development process and the purely public development process in important ways.[40]

In the conventional development process, the public and private sectors operate at arm's-length. The public sector carries on its traditional regulatory role and takes on little significant risk or cost, which are instead typically borne by the private developer and its investors. Conventional real estate projects proceed through three major phases: (1) pre-development, (2) development, and (3) post-development. The pre-development phase consists mainly of analyzing feasibility and planning; determining objectives for the development; and deciding to build, alter, or abandon the project. The development phase consists mainly of construction tasks, with attention also given to marketing and the pre-leasing or presale of space, and culminating in the completion of the building.[41] The post-development stage consists mainly of ongoing operational concerns, including tenant management and maintenance and, ultimately, disposition. Disposition tasks include preparing the site for sale or lease, and may include facility renovation or site remediation.

The public development process, in contrast, assigns all risks and costs to the public sector, and typically involves the construction of a government facility or public infrastructure. Public real estate projects proceed through the same three phases, but with some important additional tasks. First, since facility design and construction is often not a core competency of government, a bid process to select a contractor must be added to the pre-development stage. Second, evaluating and monitoring the performance of the contractor during construction must be added to the development stage. At the same time, some of the feasibility tasks essential to the private development process are less burdensome to the public developer, since there is often no requirement to prove market need for a new government facility. Importantly, regulations governing aspects of the contracting and construction process (for example, hiring), as well as political issues in all phases, can significantly slow the completion of public development projects.[42]

The public-private partnership development process adds another layer of complexity to the development process. Public-private real estate projects include most of the aforementioned steps with yet again additional tasks, most related to the negotiation and specification of the partnership agreement, as well as matters regarding disposition of the property at the end of the agreement term. While establishing the partnership is by definition a pre-development task, it is sufficiently complex as to warrant its own separate stage, typically between traditional pre-development and development tasks. It should be noted that there is often substantial duplication of tasks among partners as each strives to protect its position. In part, these duplications contribute to the generally longer time horizon necessary to undertake public-private development partnerships.[43]

Much of what follows is based on the experience of state and local governments in the use of public-private partnerships for real property. However, it is important to point out that for federal government entities, the adoption of the public-private partnership strategy rests on a different set of objectives from those in state and local government arenas. While all three levels of government seek to use partnerships to leverage public capital assets to generate private investments, they differ in their desired use of the new private revenues.

The federal government, as is argued in this report, should direct these new private revenues into the provision of federal facilities, the upgrading and renovation of older facilities, and maintenance for deteriorating assets. These objectives are in keeping with the overall portfolio goal of providing excellent working space as a means to retain human capital and to control costs.

State and local governments, for their part, view partnerships primarily as a means toward economic development: ameliorating soft market cycles, capturing value from dormant or excess assets, and creating incentives for development in areas where it might not otherwise occur. Consequently, this report represents a summary of best practices at the state and municipal levels, but with a consideration of how such practices might be best adapted to the context of federal agencies.

The public-private partnership development process detailed in this report includes the following four stages:

I. Pre-Development

II. Private Partner Selection

III. Development

IV. Post-Development

Stage I: Pre-Development[44]

The pre-development stage consists primarily of determining project feasibility and planning, as well as performing critical administrative tasks, and includes the following:

1. Rationale for Partnership
2. Legislative Authority
3. Property Selection
4. Government Partnership Team
5. Development Objectives
6. Development Program
7. Market Feasibility
8. Financial Feasibility
9. Revisit Steps 5, 6, 7, and 8
10. Development Timeline

1. Rationale for Partnership

The primary benefit of entering into public-private partnerships for the development of publicly owned buildings and real property is to leverage public capital assets to generate private investment, as discussed in detail in the report.

Of course, such partnerships are but one strategy within an overall approach to real property portfolio management, since partnerships are not always the most cost-effective means of procurement and not all properties are suitable for disposition in this manner. At the entity level, the decision to adopt public-private partnerships as part of the portfolio management strategy should include consideration of the advantages and disadvantages relative to the portfolio assets.

2. Legislative Authority

Having decided to adopt the public-private partnership strategy, it must next be determined if legislative authority exists for the entity to enter into PPPs, and if so, what the requirements are according to that legislation. For example, many state and local entities may find the authorization to enter into public-private partnerships as a part of their more general procurement legislation, with very specific regulations pertaining to bids and auctions, as well as the RFP process. However, in many states, real property transactions are exempt from compliance with this legislative authority, as are specific agencies.

Currently, no federal government entity has the express legislative authority to enter into public-private partnerships, although the Department of Veterans Affairs makes use of a technique called “enhanced-use leasing” and the U.S. Postal Service, as a quasi-public agency, has the authority to enter into PPPs.

3. Property Selection

Ideally, the identification of properties suitable for disposition through PPPs begins with an assessment of the entity’s entire building and real property portfolio to determine which properties are most suitable for partnerships. Factors to be considered include the cost effectiveness of a partnership relative to other procurement methods and whether there will be sufficient private sector interest in the site.

In the federal property management context, it may be desirable to conduct a portfolio review for candidate properties that considers a set of tests or criteria that a property must pass before consideration for partnership. For example: How was the property identified among the agency's holdings as appropriate for partnership? Was it part of a portfolio management approach? Is the property potentially of use to another federal agency or to a state or local agency?

In reality, however, conducting overall portfolio reviews to identify properties suitable for PPPs is often stymied by the availability of adequate property data and the complexity of understanding local market conditions. The availability of property data is a particular challenge in the federal government, with this issue highlighted as one reason for the designation of real property as a high-risk area in 2003. Consequently, it is often the case that a recent assessment of a particular building or property prompts a public or private entity to identify it as appropriate for partnership.

4. Government Partnership Team

Once a suitable property has been identified, the next step is to establish a government partnership team that will guide the project from its planning stage, through the selection of a private partner, to negotiation and completion of a contract, and including the monitoring and performance of the private partner. Members of the government partnership team should consist of staff with a direct interest in the project, and team composition may be directed by the enabling legislation on matters such as representation and areas of technical expertise.

Absent specific regulations on composition, the government team leader should have sufficient authority to effectively marshal the process, with a thorough understanding of public-private partnerships and the process to be followed, ideally gained through previous partnership experience. It is also important that someone on the team have a full understanding of the real estate development process and the type of project to be delivered, including construction management and public facility delivery. Other government team members should represent the various sets of technical expertise required to guide the partnership, including law, finance, facility operations, and negotiation and conflict resolution, and should include a recording secretary. Obviously, it is important that no members of the team have conflicts of interest as to the proposed development.[45]

In some cases, it may be necessary and/or desirable to engage expertise from outside of government to either participate directly in the government team, or to act as a technical advisor on selected tasks, typically local market and financial feasibility. Any outside consultants must be restricted from collaboration with a prospective private partner.[46]

5. Development Objectives

The government partnership team's first task is to conduct a needs assessment to determine the public objectives for the project, which will in turn determine risk allocation between the two partners and, ultimately, the type of partnership structure. These objectives may include earning revenues, providing a needed public facility, renovating/upgrading a public property, avoiding future maintenance problems on public sites, upgrading workspace to retain human capital, and/or other social objectives such as enabling community development. The partnership team should enumerate and rank its objectives and quantify them wherever possible. For example, the rate of return desired on public investment is 10 percent. It is imperative that these objectives be clearly stated, since they will form the basis of partner selection, the negotiation process, and deal monitoring.[47]

Once a preliminary set of objectives has been determined, the next step is to allocate responsibilities and risks among the public and private partners. The theory of public-private partnerships is based on the theory that the risk should be shifted to the party best able to assume it. Accordingly, the government team should consider which party should assume the risks of ownership, financing, design, construction, operation, maintenance, and disposition for the particular needs in question. Questions might include:

- Who can bring more innovation and efficiency to the project design?
- Who can secure construction goods and services most quickly and directly?
- Who can secure the most competitive financing?
- Who should own the facility?
- Who is in a position to operate the facility more cheaply and efficiently?
- What performance standards are necessary?

Many components of facility provision are "bundled" design-construction, ownership-financing, operations/maintenance—to save money. In general, the more risk assumed by the private sector, the greater the return or premium on capital expected by the private partner. For example, the private partner may best able to manage construction and operating risks, while the public partner may be best able to manage financing risks.

There are also important political risks to be considered when shifting risk from the public to private sectors, even in the presence of cost savings. For example, what if the private partner is non-compliant during the operating phase, affecting workspace quality for federal employees? What if the private partner goes bankrupt during the lease term? What if the value of the asset predicted at the end of the lease changes dramatically? The government team needs to consider all of these issues at the start of the partnership process.

Careful consideration of objectives and desired risk allocation should lead to the determination of a desired partnership type. Each partnership structure represents a different degree of risk allocation between the two partners, ranging from minimal public risk to maximum public risk. For example, if the government team determines that it would like to transfer all design and construction risk to the private sector but operate the facility itself, then a design-build (DB) type might be specified. If the public entity desires less risk, it may instead choose to shift the operating period risk to the private partner through a design-build-operate (DBO) partnership type.

In either case, cost savings occur through the bundling of risk for these activities to one private partner, in contrast to the traditional procurement process, where the design, construction, and operations tasks are each contracted to a different private partner. Basic factors to be considered are the preferred length of the partnership, ownership of assets during and after the partnership, treatment of public employees who may be displaced by the partnership, performance specifications, standards and expectations including roles and responsibilities of both partners, an indication of how both partners' performance will be measured, a definition of adequate rate of return, profit- and cost-sharing provisions, and performance bond requirements.

The objectives, risk allocation, and partnership type specified at this stage are intended to be preliminary, and should be revisited after considering the remaining tasks—primarily the development program, market and financial feasibility, and the private partner selection and deal negotiation processes.

6. Development Program: Nature and Magnitude of Uses

Having identified a set of desired objectives for the project, the government partnership team should next determine its desired set of uses for the property, typically expressed in land uses and square footages. Questions to be considered include the following:[48]

- What types of government facilities are needed and/or possible on the site? How much space is required?
- What types of private uses are needed and/or possible on the site? How much space is required/allowed?
- Are there any unique opportunities presented at the site, such as historic structures? How must they be addressed?
- Are there any constraints to developing the site, given local conditions including environmental remediation and local or state laws that federal development cannot supersede?
- What level of amenity will be provided (communication/technology, fixtures and furnishings, parking, landscaping, etc.)?
- Is the program feasible given current and expected market conditions? (May be less of a concern if public occupancy is guaranteed for the duration).
- Are there any community issues (such as base closure, job loss, or potential for community development at the site)? How must they be addressed?
- Are public incentives being offered to the prospective development partner? What are they, and how will their magnitude be determined?
- What is the impact of the proposed program on the desired partnership type?

Since the desired/proposed development program is a key element of the private partner selection process, it is important that the government team establishes a clear vision of the development program for the site, and then test their vision against market conditions and financial realities as outlined in the following steps. If the program is not feasible, it must be revisited and reconceived. If the project is delayed, the program often must again be revisited and reconceived. Or, if the stated program does not yield sufficient interest from developers, it must once again be revisited and reconceived.

7. Market Feasibility

For development programs that include only government uses, a market feasibility study is often not necessary since demand is already established and confirmed by the sponsoring entity. In such cases, the government team would move directly to the next step, financial feasibility.

If the proposed development program includes a private-use component, such as an office tower to be rented to non-government tenants, then it is essential that a market analysis be conducted to ensure that sufficient demand exists for those private uses within the local market over the term of the project. Since it can be assumed that the private-use component is intended to cross-subsidize the public uses of the site, determining market feasibility is critically important to the long-term success of the public component. If the market analysis suggests that the private-use program is faulty, then revisiting the project objectives and development program is necessary. Alternately, a decision can be made to abandon the project until market conditions change.

Market analyses for the private-use component of a public-private partnership should address the following components:

- Defining the market area for the proposed land uses, primary and secondary trade areas, and competitive clusters.
- Analyzing demand using economic indicators, employment statistics, visitor profiles and tourism trends, consumer demographics, demographic data sources, consumer surveys, and so on. For example, office-demand analysis considers the characteristics of the proposed building (class, location, size and flexibility, use and ownership, features and amenities), analyzing data specific to the office market, market share, and absorption.
- Analyzing supply using fieldwork, brokers, considering competition and their characteristics.

Given the highly localized nature of real estate markets, it may be beneficial for the government team to engage an outside consultant to provide a market study, especially if the proposed private use is outside of the normal range of property expertise for the agency in question. This is particularly important for supply-side studies, since local analysts often have access to valuable information (such as projects on the drawing board by other developers in the area) that could not be accessed through the aggregated public data. Of course, any market study undertaken at this stage is regarded as preliminary, and the private partner, once selected, is expected to undertake its own set of market studies based on the program of uses as they evolve during the negotiation process.

8. Financial Feasibility

The next step is to test its financial feasibility to ensure that the proposed partnership will actually save money for the government entity. The analysis generally begins by considering a benchmark scenario assuming that the facility is built and operated using the public development process, where all risks are assumed by the public sector. Additional analyses would consider alternative partnership strategies, starting with the desired type, and tweaking to show the cost savings of different risk allocations.

Financial analyses for the proposed project should address the following components, following the traditional analytical framework of real estate financial analysis, for each:

- What is the capital budget? (land, infrastructure, site preparation, facility construction, site amenity construction, soft costs (fees for design, legal, accounting, finance)
- What is the operating budget? (maintenance, grounds, mechanical systems, utilities, insurance, capital improvements, reserve funds)
- Financing: How much equity is available/required, from whom, and in what form? How much debt is available/required, from whom, and in what form?

- Non-cash assets: What else can the public partner bring to the table? Lateral agreements with other public agencies? Other types of incentives?
- Costs related to the public management of the process: typical public development, how much would management cost, versus public-private, presumably some savings but what about federal employees who do these jobs?

Of course, financial analyses completed at this stage must be considered preliminary, since there are generally only schematic drawings rather than detailed construction drawings on which to base the cost projections. Government partnership teams should be well aware that there are few cases where projected costs go down as the design process proceeds into its later stages, and thus would be wise to add an uncertainty premium to the normal contingency costs associated with capital and operating budget forecasts.

With this proviso in mind, if the analysis shows that the desired partnership type is not financially feasible (does not result in cost savings sufficient to warrant the partnership), then a return to the program concept is necessary. Alternately, the government team may use the financial analysis to determine if another form of partnership structure is desirable. If no partnership type yields desirable financial returns, a decision can be made to abandon the project.

9. Revisit Steps 5, 6, 7, and 8

Matching development objectives and program to market and financial feasibility is a highly iterative and time-consuming process. Typically these steps are revisited many times—and not necessarily in the order presented here—prior to moving on to the next step.

10. Development Timeline

Once the basic parameters of the project are established, the government partnership team should establish a project timetable, addressing the three remaining stages: private partner selection, development, and post-development. Up to this step, completing the tasks laid out in the pre-development stage can take from a few months to a year or more. The next stage, the private partner selection process, typically lasts from six to 18 months, but can take as long as two years depending on the complexity and tenor of the partnership agreement negotiations. Combined, these two stages imply that most public-private partnerships are two to three years in the planning where legislative authority for such partnerships already exists. The development or construction stage, again depending on the scale and complexity of the project, typically lasts from one to three years. Finally, the post-development stage is as long as any cost-sharing or lease agreements between the two parties, and should include time to negotiate a lease renewal or other form of disposition agreement.

Stage II: The Partnership Process

The partnership process requires the following steps:

1. Establishing the Private Partner Selection Process
2. Documenting the Selection Process
3. Establishing a Timeline for Partner Selection
4. Establishing a Process and Schedule for Stakeholder Participation
5. Selecting a Private Partner
6. Negotiating and Finalizing the Partnership Agreement

1. Establishing the Private Partner Selection Process

There are two primary ways of choosing a private partner to procure a public service: (1) the "auction-bid" approach, and (2) the "proposal call." The auction-bid approach seeks bids in response to a precisely specified development program, and the low bid wins. This approach is most effective when the government knows exactly what it wants, and generally offers less flexibility in controlling the process. In contrast, the proposal-call approach seeks proposals in response to a more generally specified program, and then chooses a partner based on a demonstration of qualifications in combination with the partner's proposed program and financing, allowing for further project negotiation after selection. For these reasons, it is generally the preferred option in cases of real property development.

The proposal-call process generally occurs over two stages: an initial request for qualifications (RFQ), followed by a subsequent request for detailed proposals (RFP).[49] The first stage involves the preparation and release of a "request for qualifications" (sometimes called a request for expressions of interest or other variations) that explains the proposed project, and asks potential partners to express their interest and present their qualifications. In this first stage, the partnership team evaluates the responses and narrows the field to a short list of three to five firms that appear to be most qualified. The short list of firms is then invited to submit more detailed proposals, initiating the second stage of the process.[50]

In the second stage of the proposal-call process, a request for proposals (RFP) is issued, typically setting out the desired development program in detail, and including information about submission requirements, evaluation criteria, and administrative matters such as deadlines and changes. From these more detailed submittals, the government team designates a private partner, and then negotiates exclusively with that partner[51] (sometimes for a prescribed period, say 180 days) to finalize the development program, financing, performance measures, and other details, summarized in a legally binding contract. The two-stage proposal-call process is described in detail below.

Using a two-stage proposal-call approach provides advantages to both the public and private partners. For the public partner, the two-stage proposal call is useful when government has identified its objectives but may not yet have fully defined the project to be delivered or does not have a good understanding of the market potential at the project site. In addition, potential private partners are effectively pre-screened for competency. The government team may decide to meet with RFQ respondents to discuss the project in more detail, thus allowing the team to subsequently clarify the RFP. For the private partner, the RFQ stage typically represents a minimal time investment, whereas participating in the RFP stage is often a major time investment. Should a firm make the short list to participate in the RFP, it is guaranteed serious consideration in a competition limited to a few peer firms or combinations of firms.

2. Documenting the Selection Process

Documenting the private partner selection process is essential to ensure that the process is open, fair, and transparent. A well-documented process serves as the basis for building trust with end users, other stakeholders, and future partners, as well as the basis for any subsequent legal inquiries.

The recording process should include:[52]

- A description of the partnership selection process that was chosen and why
- The partner selection timeline
- The names of all respondents to the RFQ and RFP
- Evaluation criteria for both stages
- A written review of each proposal at the relevant stage
- Reasons for eliminating prospective partners during both stages
- Minutes of all meetings
- A record of all additional information requested by respondents and how it was handled

3. Establishing a Timeline for Partner Selection

One of the most striking differences between the public-private partnership strategy and the traditional public development process is the time cost associated with the partner selection process. Before requesting proposals, the government team should establish the schedule for the private partner selection process as well as a general timeline for completion of the project itself.

The private partner selection timeline should include the following tasks:[53]

- Securing the required approvals to undertake the proposal call
- Selecting the government evaluation team (that will make the private partner decision if it is a different committee from the government partnership team)
- Drafting and advertising the RFQ
- Drafting and advertising the RFP
- Evaluating the RFP
- Holding information meetings with potential partners (can be individual, but less likely to seem fair, yet individual meetings maintain confidentiality and yield better answers to questions)
- Holding public meetings (separate from the information meetings)
- Evaluating proposals and selecting the successful partner
- Debriefing of non-successful private partners

The development agreement/negotiation timeline might include the following tasks:[54]

- Selecting a team to negotiate the development agreement and contract (a subcommittee of the government team with or without additional consultants)
- Drafting and finalizing the Memorandum of Understanding (MOU)
- Providing an overview of the public process, including advertising, notification, disclosure of agreements, counter petition process, and assent of electors
- Preparing contract documents
- Ratifying draft contract
- Securing of financial approvals

4. Establishing a Process and Schedule for Stakeholder Participation

Prior to finalizing the RFP, it is important that the government partnership team engage the participation of key stakeholders not represented on the team at the appropriate times during the process. Acknowledgment and participation of key stakeholders is critical to the successful implementation of the project. Participation ensures that their objectives, concerns, and needs are addressed during the process in a meaningful and transparent manner. In many cases, stakeholders may provide input that adds clarity and value to the final RFP.[55]

These stakeholders might include:

- State and local government representatives
- Any other approval agencies or affected agencies
- End users of the building or facility
- Agencies involved in financing
- Unions
- Local interest groups/neighbors

Stakeholder participation is also an important part of the overall project communication strategy (not just private partner selection), and methods for disseminating information and collecting responses should be provided in the overall project strategy.[56] The extent of the strategy should reflect the scope of the project and existing or expected interest in it by stakeholder groups. Larger, more controversial projects should be accompanied by an extensive consultation process that incorporates a variety of approaches and methods over an extended period of time. Components of a stakeholder participation strategy might include:[57]

- Objectives of the consultation and communications strategy
- Identification of key stakeholder groups and their interests in the project/service initiative
- Key milestones where consultation and communication is required or desirable
- The overall approach and methods to be used for informing the stakeholders as well as receiving input from them
- Communication: print media (newspaper advertisements, flyers, direct mailings, newsletters), radio advertisements, TV advertisements, cable access TV programs, public meetings, dedicated phone line, Internet website, information center, open houses
- Consultation: surveys, Internet website with feedback, phone line with feedback, open houses, workshops/seminars/charettes, public meetings
- The involvement of the media in the communications process
- The ways in which statutory requirements are to be met, including notification, advertising, disclosure of agreements, counter petitions, and elector consent (if needed)

5. Selecting a Private Partner

Once the government team has developed a strategy for implementing the public-private partnership, its attention focuses on selecting the preferred private partner. This involves six steps.

5.1 Issuing a Proposal Call to Prospective Private Partners

The proposal-call package is a critical document in the public-private partnership development

Steps in Selecting a Private Partner

5.1. Issuing a proposal call

5.2. Issuing RFQ

5.3. Evaluating RFQ responses and selecting short list

5.4. Issuing RFP

5.5. Evaluating RFP responses

5.6. Selecting partner

process. Ideally, it will attract the interest of target developers while effectively setting the ground rules for the partnership.

The proposal call can be administered in one or two stages. In a one-stage proposal call, the government team would begin the private partner selection process by issuing a Request for Proposals. In a two-stage proposal call, the selection process begins by issuing a Request for Qualifications to pre-qualify a short list of three to five prospective partners eligible to respond to the RFP. The RFQ is shorter, and usually asks only for developer's qualifications, including as a builder, as a financier, experience building this type of property, in this market, working with public partners, etc. The two-stage process also presents significant advantages to the prospective private partner because the response to an RFQ requires only limited resources, whereas a response to an RFP requires a significant commitment of resources. Private partners are much more likely to commit the time to respond to an RFP if they are certain to be on the short list of prospective partners.

5.2 Issuing an RFQ to Prospective Private Partners

The purpose of the RFQ is to explain the proposed project and to ask potential partners to express their interest and present their qualifications. In this first stage, the government team evaluates the responses and narrows the field to a short list of three to five firms that appear to be most qualified.

The RFQ package should include:[58]

- The public partner's objectives in seeking a PPP
- A description of the existing project site
- A description of the proposed development program
- A description of the current regulatory context
- The nature of the proposed partnership
- The contribution and expectation of skills to be provided by the private partner
- Mandatory submission requirements (plans, financials, etc.)
- A statement clearly specifying the scope of the project and the government's needs
- A profile of the prospective private partner making the application (if there are multiple partners forming a consortium, then each should have a profile, including their principal business, etc.)
- The identification of a contact person for the private partner
- A statement of financial stability (that can be evaluated on a pass/fail basis)
- A statement of financial capability including access to capital (debt and equity)
- A statement of performance capability that includes an overview of overall experience, experience in similar projects, senior management expertise, expertise of staff members who will work on the project, the ability to obtain necessary resources, references
- In terms of response length, a rule of thumb would be 15 to 30 pages for an RFQ depending on the scale and complexity of the project
- Other instructions to respondents (closing date, further inquiries)
- Evaluation scheme including weightings, points, or other considerations that will be applied to each element of the criteria (see step 5.3)
- The full extent of the selection process, including timetable

Once drafted, the RFQ should be advertised in appropriate places (local newspapers, development periodicals, etc.) The advertisement should be placed for 30 to 60 days, as a general rule, with an additional 30- to 60-day period for responses to be submitted. The advertisement should contain:[59]

- A brief description of the project
- The role that will be played by the successful private sector partner
- The number of companies that will be short-listed and receive the RFP
- The location and deadline for submissions
- The expected format of submissions
- A contact name
- An address where the full RFQ can be obtained

5.3 Evaluating the RFQ Responses

Responses to the RFQ are first vetted for compliance. If a submission is incomplete, the government team has the option of eliminating that proposal from further consideration or allowing the prospective private partner to resubmit. If this courtesy is extended to one respondent, it should be extended to all.

All compliant RFQ responses are evaluated based upon the likelihood of the respondent to successfully meet the stated objectives of the project. Generally, responses are evaluated by assigning a numerical judgment or "score" in accordance with how well the response addresses each evaluation criterion. Each criterion is, in turn, weighted according to its relative importance in the evaluation, and the three to five highest-scoring responses are selected to respond to the second-stage request for proposals.

Respondents' qualifications should be ranked among the group, weighted equally across the criteria (or otherwise as appropriate), with the top three to five selected to respond to the RFP. As for those respondents not selected to continue in the process, the government team may choose to meet with them to discuss why they did not make the short list. It is important for the team to keep in mind that all submissions will have sensitive information and, therefore, confidentiality is expected.

5.4 Issuing an RFP to Prospective Private Partners

In the second stage of the proposal-call process, a request for proposals is issued, typically setting out the desired development program in detail and including information about submission requirements, evaluation criteria, and administrative matters such as deadlines and changes. From these more detailed submittals, the government team designates a private partner and then negotiates exclusively with that partner[60] (sometimes for a prescribed period, say 180 days) to finalize the development program, financing, performance measures, and other details, summarized in a legally binding contract. The two-stage proposal-call process is described in detail below.

The RFP is a complete guide to the proposed project, building on the RFQ but providing substantial additional detail that will be required for the short-listed prospective partners to create their submittals.

The RFP should include all of the information in the RFQ and at least the following:[61]

- Introduction
- Description of the proposed relationship between the local government and the selected partner
- Proposed format and mandatory submission requirements
- Detailed description of risks the local government will not assume under any circumstances, as well as how the risks will be shared in general
- Explicit performance specifications, standards, and expectations of both the prospective private partners and government
- Design and construction requirements
- Management and operating requirements (if applicable)
- Proposed business plan
- Detailed financial information and a proposed financing plan and pro forma for the project
- Transfer plan for any capital assets including a description of the proposed lease (if applicable)
- Limitations on mortgaging and assigning rents
- Legal considerations

- Consideration for employees who may be displaced by a partnership
- Permit requirements
- Proposal evaluation criteria
- Proposal evaluation process
- Form of discussions permitted between the government and potential partners in relation to their proposals prior to selection of a preferred partner
- Bonding requirements
- Contract award process
- Process for measuring performance
- Statutory requirements that government must comply with relating to disclosure of intentions, counter petition (if applicable), and assent of electors (if applicable)
- Deadlines for preparation and delivery of submissions
- Communication channels—the means by which potential partners may seek clarification of the RFP document
- Identity of a local government officer who is authorized to discuss and present information to prospective partners
- Appeal and rights of review
- Restrictions of potential partners to discuss the RFP with third parties
- Appendices (with other relevant information, such as labor contracts, and the government's policies with respect to PPPs)

Again, some of the information provided will be proprietary, and it should be clearly expressed how this will be handled, including relevant privacy and freedom of information laws.

The timeline is usually 45 to 90 days to prepare the submission. It can be either short and open-ended or long and detailed with respect to land uses, design guidelines, and business terms. Regardless of its length, the RFP requires the public entity to assess its specific objectives for the project with an eye to defining broadly the character of the private development, identifying public roles and the available types of assistance, structuring a set of project-specific planning conditions and business points to which developers must respond, and providing for an orderly and clearly understood procedure for evaluating proposals.

The level of specificity is often a function of local market conditions. When the market is weak and the site is untested, attracting developers may require a detailed prospectus and feasibility study. When the market is strong, less documentation may be needed, but more attention must be devoted to other matters, particularly the detailed terms and conditions for the contemplated business deal. It is difficult to recommend one "best" approach to the RFP, because of vast differences in market dynamics, site characteristics, public objectives, and legal alternatives for designating developers.[62]

5.5 Evaluating the RFP Responses

The three to five prospective private partners responding to the RFP will return lengthy and complex documents. Often they are invited to make formal presentations. It can be very difficult for the government team to make the final selection, since development programs can be equally compelling but for very different reasons—for example, one for its financial return to the public partner and another for its program innovation.

It is recommended that the team come up with some sort of proposal evaluation criteria in advance of the final interview and submission. Criteria might include: developer reputation and experience, developer financial capacity, feasibility of the program, innovation, return to the public partner, and so on.

Before making a final selection (or even before issuing the RFP, that is, after receiving the RFQs), it is not uncommon for the partnership committee to revisit the proposed program, market analysis, and/or financial analysis to determine if any changes or fine-tuning is required. They might also revisit their go/no-go decision based on this analysis.

5.6 Choosing a Private Partner

The successful private partner (designated) is invited to negotiate and formalize a partnership agreement. During this stage it is typical to fine-tune the program, market analysis, and project. However, committees should be careful to ensure that the developer has not promised something during the selection process that it is not willing to commit to as part of the formal agreement. The team must leave themselves room to re-initiate talks with other respondents. In the meantime, other respondents should be advised that they are not the first choice; they also should be advised that if the first developer drops out, the committee might re-initiate discussions with them.

6. Negotiating and Finalizing the Partnership Agreement

When it comes time to negotiate the formal partnership agreement, there are a number of items to be discussed. Typically, these terms are written up in a document called a "memorandum of understanding" (MOU), so named as to indicate agreement between the two parties. When these terms are finalized, the MOU will form the basis of the development agreement (DA) and may also be included as an appendix thereto.

Both the MOU and DA set out in detail the functional and financial responsibilities of both the government and private partners throughout the construction, operation and maintenance, and disposition phases, as appropriate to the project.

Functional issues include which partner is responsible for design, approvals, financing, site preparation, infrastructure, building, other site improvements, marketing, and pre-leasing. Financial issues include how much each partner is contributing at what time, responsibility for insurance, cost overruns, and so on.

The MOU and DA also include discussion of profit sharing and other financial partnership matters. They include a projection of the project timeline, and a process for handling time delays, cost overruns, and how and when shared revenues will be disbursed. They may or may not include performance guarantees. They will indicate who is responsible for the ongoing operation and maintenance of the property, as appropriate. They will address the process of disposition (sale or release) or return to the government partner (if DBO, etc.). They also include a process for handling mediation and conflict resolution, in addition to a provision where the partnership can be dissolved prior to construction, if necessary, allowing the public sector to find another partner.

Stage III: Development/Construction

The development and construction process involves the work on the site, and typically ranges from one to five years depending on the complexity of the project.

Obtaining the necessary approvals is the first step, and if the project is using private debt, these approvals will be necessary before funding is released (and for permanent financing, pre-commitment letters from key tenants may be needed). Depending on the nature of the project (whether it has a market component), there may or may not be local and/or state, or other federal agency review and/or approval required. (In many cases, federal property is exempt from local regulation and review, but the plans are presented anyway as a political or community gesture). Even in a relatively straightforward, noncontroversial project, the approvals process can take a year or more.

During the approvals phase, it is often necessary to revisit the preliminary designs in response to review comments and to changing market conditions, especially if the project has taken a long time in the predevelopment stage. The design will also have to be tweaked once construction begins, as is often the case, due to unknown conditions on the site and other issues.

Stage IV: Post-Development and Disposition

In accordance with life-cycle asset planning models, advance consideration should be given to the disposition of the property at the end of the agreement. The most common practice is to keep the land in public ownership over the duration of the agreement. Options include sale or re-leasing. Sale disposition can generate significant upfront revenues for use in other public projects, eliminate the risk of future nonpayment, and, under certain conditions, promise higher dollars for the public treasury than lease arrangements. In terms of controlling land use, restrictive covenants can be attached to property deeds as a condition of sale, as was the case with urban renewal dispositions.

As a means of managing the development of large-scale public-private projects, many cities have found that leasing offers more advantages. The ground lease form of disposition creates an ongoing business relationship. For the developer, leasing minimizes the upfront capital investments and makes more efficient use of taxable deductions. For the government agency, retaining ownership of the land allows the public to benefit from rising land values through lease payments and percentage rents, thereby capturing the residual value of the built improvements.[63]

Alongside these benefits, however, lies the potential for conflict and tough lease negotiations, especially if the RFP does not include a pattern lease document that sets out the terms and conditions affecting the developer's bid. Structuring a ground lease that is acceptable to the long-term lender is the developer's main objective. In strong markets, governments often do not subordinate the land; for reasons of both business and policy, public officials generally want participation in project revenues above a base fixed rent. To control its exposure to the political as well as business risks of taking a proprietary interest in a private investment, the public sector seeks tight lease conditions and, through participation formulas, protection against charges that the developer is earning a "windfall." Both positions present problems for institutional lenders seeking protection from the potential loss of control through foreclosure by the government fee owner.

Endnotes

1. Two bills were introduced in the 106th Congress (1999) proposing partnership authority for federal agencies. Neither bill passed. For more detail, see the section of this report titled "The Challenge of Implementing Public-Private Partnerships at the Federal Level."
2. GSA Federal Real Property Profile, 2002. Does not include stewardship assets such as those owned by the Department of the Interior and the Department of Agriculture.
3. GAO-05-207, 1.
4. GAO-05-207, 48.
5. Ibid.
6. GAO-03-122, 11.
7. Ibid, 8.
8. Ibid, 9.
9. Ibid, 10.
10. GAO-03-122, 15. Deferred maintenance is maintenance that was not performed when it should have been or was scheduled to be and that, therefore, is put off or delayed for a future period. *Sustain* refers to efforts required to keep a facility at its current physical condition using operation and maintenance funds. *Recapitalize* refers to efforts to improve the condition or replace a facility with new construction, using either operation and maintenance or military construction funds.
11. Ibid, 16.
12. Ibid, 21.
13. Ibid, 22.
14. NRC, Stewardship of Federal Facilities: A Proactive Strategy for Managing the Nation's Public Assets in GAO-03-122, 24.
15. GAO-03-122, 26.
16. Ibid, 27.
17. A material weakness is a condition that precludes an entity's internal controls from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. GAO-03-122, 27-28.
18. GAO-03-122, 30.
19. Ibid, 31.
20. Ibid.
21. Ibid, 30.
22. Ibid.
23. Ibid, 32.
24. Witherspoon, 1982, 2.
25. Williams, 2003. This report summarizes PPPs for public services and infrastructure provision, particularly the provision of transportation and water/sewer infrastructure.
26. For example, Miles et al. (2000, 280) note that though partially publicly-funded, a quasi-public development organization can conduct negotiations in private—a particularly useful feature as developers are reluctant to negotiate when the details of their financial dealings are made public.
27. Sagalyn in Miles, 2000, 274.
28. Bernard Shaw and Isadora Duncan are seated across from one another at a dinner party. Ms. Duncan exclaims, "Mr. Shaw, imagine if you and I had children; your brains, my beauty!" Mr. Shaw replies, "Indeed, madam, but what if the reverse occurred?"
29. The discussion of advantages and disadvantages to public and private partners is a synthesis and updating of earlier work by Witherspoon (1982), Sagalyn (in Miles, 2000), Stainback (2000), and informed by Professor Jerold S. Kayden, Harvard University Graduate School of Design, in his course "Public and Private Development."
30. Williams, 21. All subsequent definitions are from Williams' IBM Report dated 2003, although it is acknowledged that much of this terminology is standard throughout the industry. In the case of federal property specifically, GAO-GGD-99-71 (1999) Public-Private Partnerships: Terms Related to Building and Facility Partnerships also provides a glossary of related terms.
31. GAO/GGD-99-71.

32. GAO/GGD-99-71.

33. Ibid.

34. GAO-03-122.

35. Ibid.

36. GAO-02-46T, 6.

37. GAO-01-906, 4.

38. GAO-01-906.

39. Stanton, 2003, 8.

40. This discussion is based on previous work by Witherspoon (1982), Sagalyn in Miles (2000), Stainback (2000), the British Columbia Ministry of Municipal Affairs, Canada (1999), and Asner (2003).

41. Witherspoon, 5.

42. Ibid, 6.

43 Ibid, 3.

44. It is important to note that each individual project will be different, and thus will involve different emphases on different steps and, in some cases, elements (and perhaps innovations) not envisioned here. Second, the process is highly iterative; that is, later steps may require revisiting earlier steps. Third, each partner may have to complete a single step (duplication).

45. BCMMA, 46.

46. Ibid.

47. Ibid, 48.

48. Witherspoon, 18.

49. There are variations on the two-stage process presented here, but none really qualifies as a method that is in widespread usage today. First, a "one-stage" proposal call is possible when government has a few selected partners in mind who have already proven their capability to be successful partners, and when only a limited number of potential partners have the expertise to be a successful partner, such as the construction of a highly unusual type of federal facility. Most one-stage processes streamline either the RFQ (by sole sourcing) or the RFP (negotiate rather than RFP) step in the process. Given the movement toward increased accountability and transparency in procurement, none of these one-step variations is likely to pass political and legislative muster in the context of real property transactions.

Stainback (2000, pp. 81–82) also presents a three-step RFI/RFQ/RFP process that differs from the traditional two-stage process by adding the initial step of seeking "requests for information" (RFI), which seeks to get an "initial reaction" from potential private sector partners about the development opportunity and its fit with prevailing market conditions. While it is not clear that this represents an actual third step, he does not recommend use of this approach anyway, since it is time-consuming and unlikely to yield the kind of market insights desired because respondents wish to maintain their competitive edge.

50. BCMMA, 55.

51. In some cases, the private partner is designated as the preferred partner for a specified period, say 180 days, after which time, if no agreement has been reached, the partnership team is allowed to return to the pool of short-listed teams and designate another preferred partner. Obviously, such a clause works to the advantage of the partnership team such that they are not needlessly restricted to working with one partner if a satisfactory deal cannot be struck, nor would they need to reinitiate the RFP process.

52. BCMMA, 61.

53. BCMMA, 57.

54. BCMMA, 58.

55. Ibid.

56. BCMMA, 59.

57. Ibid.

58. Ibid, 64.

59. Ibid, 64.

60. In some cases, the private partner is designated as the preferred partner for a specified period, say 180 days, after which time, if no agreement has been reached, the partnership team is allowed to return to the pool of short-listed teams and designate another preferred partner. Obviously, such a clause works to the advantage of the partnership team such that they are not needlessly restricted to working with one partner if a satisfactory deal cannot be struck, nor would they need to reinitiate the RFP process.

61. BCMMA, 67.

62. Sagalyn in Miles, 277, and ULI Codevelopment Handbook.

63. Sagalyn in Miles, 2000, 228.

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