

ALTERNATIVE FINANCING OF PUBLIC SCHOOL FACILITIES

ANNUAL REPORT ON THE STATUS OF ALTERNATIVE FINANCING, PROJECT PROCUREMENT, AND PROJECT DELIVERY FOR MARYLAND PUBLIC SCHOOL CONSTRUCTION

**SUBMITTED TO THE BOARD OF PUBLIC WORKS
Governor Robert L. Ehrlich, Jr.
Comptroller William Donald Schaefer
Treasurer Nancy K. Kopp**

September 1, 2006

The Interagency Committee on School Construction

Dr. Nancy S. Grasmick, State Superintendent of Schools, Chair
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Mr. Fred Puddester, Appointee, Speaker of the House
Dr. David Lever, Executive Director

(MSAR # 2498)

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 - C. Workgroup on Project Procurement, Delivery, and Alternative Financing
 - D. Regulations Workgroup
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BACKGROUND

In 2002, the Task Force to Study Public School Facilities was formed under the leadership of Treasurer Nancy K. Kopp to determine if Maryland's public school facilities were adequate to support the educational programs that will be funded through the Bridge to Excellence in Education Act of 2002. The Task Force investigation was broad, including not only the adequacy of public schools but also the procedures and practices that govern their procurement, delivery, and financing. A subcommittee of the Task Force, chaired by Dr. David Lever, Executive Director of the Public School Construction Program, investigated the feasibility of using alternative financing mechanisms to assist in the task of building and renovating Maryland's public schools (Appendix A). This subcommittee studied the experience of school districts in the United States and Canada that have used alternative financing to build public schools, and developed recommendations that were included in the Final Report of the Task Force, issued in February 2004.

During the 2004 session of the General Assembly, school construction received a great deal of attention. Senate Bill 787 / House Bill 1230 (Chapters 306 and 307, Laws of Maryland), titled as the Public School Facilities Act of 2004, was an omnibus bill that addressed many aspects of school construction procedure and funding, included a section on alternative financing (Appendix B). This statute contains provisions that enabled the LEAs and local governments to use alternative financing arrangements: lease-leaseback, sale-leaseback, public-private partnerships, and performance based contracting. The statute allows the use of finance-design-build, a variant on the traditional design-build (DB) project delivery methodology in which the DB entity also provides financing for the project. Besides design-build, the statute addresses another method of project delivery, construction management at risk (CMR), that has proven successful in the private sector but was not undertaken in public school construction in Maryland because it does not work well in a competitive bidding environment. Finally, the statute enables the local jurisdictions to use methods of project procurement - competitive negotiation, unsolicited proposal, and quality based selection (QBS) - that were not previously allowed for public school construction.

STATUS OF PROCEDURES AND REGULATIONS

The statute charged the Board of Public Works with developing regulations to govern the implementation of the alternative financing and other provisions of the Act. Draft procedures were developed in the summer of 2004 by the staff of the Public School Construction Program. In drafting the procedure on alternative financing, it was found that wholesale revisions were also needed to the PSCP procedures that governed project procurement and delivery but that

no longer reflected contemporary practice nor aligned with the 2004 legislation. Consequently, the draft included three highly interconnected chapters in order to capture the full scope of the problem.

In January 2005, a Workgroup on Project Procurement, Delivery, and Alternative Financing was established under the chairmanship of Dr. Lever. The membership included superintendents of Maryland school districts, facility planners from the school districts, representatives from local governments, and representatives of State agencies that have an interest in public school construction or experience with the types of problems that were under discussion (Appendix C). Deliberations were open to the public and were attended by several interested private sector financial and construction groups. Subgroups within the larger workgroup addressed the three chapters on project procurement, delivery, and alternative financing. The final draft of the revised procedures was released in May for general comment by local school systems, local governments, and a broad array of private sector firms and individuals, including financiers, construction managers, and others with an interest in the subject (the draft procedures may be obtained from the PSCP on request).

Concurrent with the review period and continuing until November 2005, a small group consisting of attorneys from the Office of the Attorney General and the Board of Public Works met regularly with Dr. Lever to convert the three procedural sections into regulation (Appendix D). This group assimilated the comments that were submitted in response to the May 2nd documents. To align the complexities of school design and construction with the requirements of regulation proved to be a task requiring lengthy detailed discussions. Consequently, the procedures were not ready for promulgation on July 1, 2005, as required by the Act. On January 4, 2006, the draft regulations were released for comment to local educational agency and local government officials as well as State agencies. Their comments were assimilated and the revised regulations were reviewed again by the small regulatory workgroup. The draft regulations were sent to the members of the Interagency Committee on School Construction (the IAC) on June 21, 2006. Comments were received from the Maryland State Department of Education Facilities Branch, representing the Chair of the IAC, Dr. Nancy S. Grasmick. Final changes were made to the regulations, and following a briefing with the liaisons for the Board of Public Works members scheduled for September 11, 2006, the regulations will be presented to the BPW on September 20, 2006, for approval to publish. With this schedule, it is anticipated that the regulations will be approved in the early part of calendar 2007.

It is the understanding of the Public School Construction Program, some of whose staff were involved in drafting the 2004 legislation, that the General Assembly intended the provisions of the act that concern project procurement, delivery, and alternative financing to become effective on July 1, 2004 in order to address an immediate crisis in public school construction. Consequently, the PSCP advised the local school systems that they could proceed with the new methodologies outlined in the legislation, using the statute for guidance, as well as prudent common sense and frequent communication with the Public School Construction Program to avoid actions that might be outside of the domain of the Act or other State laws and regulations. The PSCP and others recognized that the experience gained by the local entities in exploring these methodologies would be of great benefit to the writers of the procedures and regulations, since the consistent desire has been to provide realistic guidance to facilitate private sector participation in the construction of public schools while honoring fundamental principles of public school procurement. These principles can be summarized as:

- Requiring procurement to be open and fair, so that all eligible vendors are provided with an opportunity to participate if they qualify;

- Ensuring that the process of procurement will result in the best value for the taxpayers of Maryland;
- Ensuring that the process will deliver public school facilities that meet the educational and building performance standards that would apply to a Maryland public school building procured, delivered, and financed through conventional methods;
- Ensuring that State requirements for minority business participation and for use of prevailing wage rates are incorporated into projects procured under alternative methods when applicable, as they would be for projects procured and financed through conventional methods.

At the same time, it was recognized that if the procedural and substantive requirements for alternative methods were too stringent, private sector vendors might lose interest in participating in public school construction. The final draft regulations therefore represent a balance between the need to protect the public interest and the desire to involve the private sector in this large task.

SCOPE OF THE LEGISLATION

The first project to be reviewed by the Office of the Attorney General for conformance with the alternative financing provisions of the Public Schools Facility Act of 2004 was the central administration building for Harford County Public Schools (HCPS). A description of the building and its financing structure is provided below on page 6.

In a letter dated September 21, 2004, the Office of the Attorney General indicated that projects of the type then proposed by HCPS fall under the authority of the Public School Facilities Act of 2004 (copy attached). Consequently, such projects would need to be procured and reviewed in accordance with the requirements of the legislation and of regulations that had not, at that time, been drafted. However, because the HCPS project pre-dated passage of the Public School Facilities Act, the OAG also excused it from compliance with review by the IAC and from the competitive procurement methods outlined in the legislation.

Subsequently, discussion between the OAG and the PSCP has led to a reappraisal of the scope of the legislation. In brief, our position and that of the OAG is that neither the intention of the original legislation nor the traditional review and approval functions of the IAC and its designees warrant an extension of these activities into the arena of central administration buildings. Since such buildings are not funded by the State under the Capital Improvement Program or the five other programs that the PSCP manages, they have not traditionally been subject to the review and approval of the IAC; nor do they contain the educational purposes that warrant review and approval of locally funded projects by the State Superintendent. Please see attached letter dated August 29, 2006, for a more detailed explanation of the position of the OAG on central administration buildings, a position that coincides with our own.

Clarification of the scope of the Public School Facilities Act of 2004 with respect to central administration buildings will not only preserve the traditional focus of the Public School Construction program on the facilities that support educational programs, but will also provide greater latitude to the LEAs to explore innovative alternative approaches to their facility concerns. Indeed, the most important and interesting alternative financing discussions underway at this moment between LEAs and private entities concern central administration

facilities (see below, page 6). It is anticipated that lessons learned in these projects will have implications for the eventual application of alternative financing to school facilities.

STATUS OF SCHOOL DISTRICT INITIATIVES IN PROJECT PROCUREMENT, PROJECT DELIVERY AND ALTERNATIVE FINANCING

Alternative Financing

As we reported in September 2005, interest in the use of alternative financing methods to build schools remains extremely hesitant. In the 2005 report, we noted the risk-aversion that is inherent in the construction of public schools and that frequently restrains the adoption of innovative techniques, including alternative procurement, delivery, or financing methods. As in September 2005, the LEAs continue to indicate that alternative financing offers no financial advantage over conventional financing using general obligation bond revenues. As examples, Calvert County Public Schools and Harford County Public Schools have both explored alternative financing for a new middle school and the replacement of an existing high school, respectively, and both have concluded that their projects can be carried out at lower cost and with less risk using conventional bond financing. Cecil County Public Schools also reports that it is no longer pursuing alternative financing for the construction of a new technology high school.

To date, only one school system appears to have used an alternative financing arrangement for a school, and then only for a relatively limited scope of work. Prince George's County Public Schools procured the furnishings and equipment for the new Dr. Henry A. Wise, Jr., High School, which opened in August 2006, through a lease-purchase financing agreement. The lease purchase agreement included \$6,500,000 for the purchase of moveable and infrastructure equipment. School board operating funds are being used to repay the five-year financing agreement. Redirecting the cost of this equipment to the operating budget released county debt to complete the construction of the school.

The hesitancy of the LEAs to use alternative financing for school construction corroborates the findings of the alternative financing subcommittee of the Task Force to Study Public School Facilities. In 2003, the members of the subcommittee recognized that there was no evidence, all other things being equal, that a project can be delivered through alternative financing at lower cost than through the use of conventional general obligation bonds. The private sector does not have access to funds at the same favorable interest rates as local and State governments, which can pledge the full faith and credit of the public to support the bonds, a disadvantage that is fully acknowledged by almost all private sector vendors of alternative financing methods. While it is clear that many school districts are under intense pressure to build new schools and renovate existing schools, evidently they do not feel that the urgency is sufficient to warrant the uncertainties or costs of venturing into alternative financing approaches. Two exceptions to this general observation are energy performance contracting and central administration buildings:

Energy Performance Contracting (also called Performance Based Contracting and Guaranteed Performance Contract)

A greater number of LEAs are now involved with energy performance contracting (EPC), in which savings that accrue from energy-related improvements are used to finance the improvements over an extended amortization period. As energy costs continue to rise, this approach has become increasingly attractive in order to improve both the energy performance and the comfort of Maryland's many older facilities, which were frequently built to low energy standards in the 1960s and 1970s. In some cases, the energy saving scope for a school includes a capital improvement program project funded by the State; in this way, greater

efficiency in procurement and better overall costs are obtained. Since the energy service companies (ESCOs) that provide the improvements must guarantee savings for a number of years (typically 15), they are obligated to provide routine preventive maintenance on the equipment that they install. If the savings are not realized, the ESCO is obligated to reimburse the "lost" savings to the local board. Following are a few current instances of this approach:

- *Carroll County Public Schools* has entered into a fourth performance contract with an energy management company that includes new air conditioning (AC) projects for three schools in addition to energy saving projects (lighting, bathroom fixtures, control upgrades, high efficiency HVAC equipment, billing evaluation services, etc). Providing AC in all schools is a high priority for the school system. The three previous phases with the same contractor met the stated goals in all but one instance and the energy management company paid the savings as agreed. The contractor has now completed their phase-four installation work and the school system expects this year to be the first for energy cost avoidance.
- *Cecil County Public Schools* approved in 2005 a \$9.3 million dollar performance contract with an energy management company for energy related facility improvements to all 29 schools in the county as well as the central office. Projects range from boiler replacements to lighting upgrades, as well as a complete wide area network (WAN) technology. These upgrades show a payback over a 15 year period with the energy management company guaranteeing the energy savings. The school system received a favorable opinion from the county's bond council on the issue of how bond ratings are affected when capital projects are funded through this method. The performance contract is now 70% complete and some benefit in utility usage has already been experienced.
- *Howard County Public Schools* is in the second year of a multi-year energy performance project. To date, 13 schools have been contracted for conservation measures. An estimated \$600,000 in annual savings is projected for the 13 schools when the two phases are complete and operational.
- *Prince George's County Public Schools (PGCPS)* has piggybacked on the State Department of General Services' Indefinite Delivery Energy Performance Contract (EPC). The School Board has approved contracts with two energy management companies to conduct facility audits for 204 facilities. Upon completion of this Phase I work, a proposed project plan, scope of work, and cost avoidance/savings utilization schedule will be presented to the Board for approval and inclusion in the Phase II implementation plan. We understand that PGCPS is currently exploring various financing sources to obtain the best value. The school system expects that the EPC Program will guarantee future energy savings that will fund approximately \$94 million of facility improvements over a 15 year period.
- *Baltimore City Public Schools (BCPSS)* has entered into agreements with four ESCOs under the DGS EPC program. Each ESCO will provide energy improvements to a number of schools, and each will in addition provide preventive maintenance (PM) for all mechanical systems in the schools that receive energy improvements as well as in other geographically related schools, irrespective of whether the HVAC equipment was installed by the ESCO or not. The energy improvements are often hybrid projects, in that lump-sum funding through the State's Capital Improvement Program and Aging School Program are combined with financing secured by long-term energy savings and

other local funds to execute the capital projects. As BCPSS will close three schools for the 2006-2007 school year, priority has been given to capital projects in the schools that will receive students from the schools that will close; these schools will also receive other improvements unrelated to the EPCs, e.g painting and new ceilings. Reports to date indicate that the ESCOs are performing above expectations and that the level of quality is high.

The HVAC preventive maintenance tasks that lie outside of the ESCO's normal obligations with respect to the equipment they install will be funded through the school system's operating budget (it should be noted that this issue was given a very high priority in the formulation of the FY 2007 operating budget). All schools in the system will be included for HVAC PM in one of the four ESCO contracts. PM has been repeatedly highlighted by the IAC as one of three factors that will have a bearing on the IAC's recommendations for systemic renovation project approvals in the FY 2008 CIP (the other two factors being school closures and progress on previously approved projects). BCPSS has thus provided a model of how a school system with an aged and very deficient building inventory can accomplish significant upgrades, improve building performance, and concurrently implement a PM program for building components that have a considerable impact on occupant health and productivity.

Central Administration Buildings

The most significant activity in alternative financing of LEA facilities is currently in the arena of central administration functions, which includes not only central office facilities but also warehouses, garages, parking areas, and staff development buildings. Interest may have shifted to this type of facility for several reasons:

- A reluctance on the part of county governments to issue debt for administration facilities, in which the State does not participate through its capital funding programs.
- Anticipated improvement of administrative and operating efficiencies by consolidating into a single facility functions previously housed in geographically separated and obsolete buildings, sometimes using the avoided costs of rent payments, or the sales of the former administration buildings, to offset the costs of the new structure.
- The view of developers and financiers that administration buildings that are built to office standards offer more possibilities for re-use and marketability than do school buildings, and consequently offset the risks associated with potential non-appropriation of lease payments.

We are aware of the following central administration projects that are at various stages of development:

- *Harford County Public Schools (HCPS)*
 - HCPS has completed a 73,000 square foot central administration building in downtown Bel Air through a lease-leaseback financing arrangement. Central office functions previously housed in the existing administration building dating from 1872 and in four other leased offices have been consolidated into the new facility. Avoided rents on two of these administrative offices are used to partially fund the lease payments. It is expected that the administration of the school system will improve in efficiency through centralization of central office functions. Following competitive negotiation to procure a combined construction and finance package, the construction contract was awarded but it was decided to procure the financing

separately through competitive negotiation with a number of banks. The term of the lease-leaseback finance agreement is 25 years, with a ground lease on the land only and assumption of title by the Board of Education after 25 years. There is no pre-payment penalty. Construction funds were placed in an escrow account through a Mutual Fund consisting of US Treasuries.

It is anticipated that over the 25 year fixed lease period for the new building, the savings generated through avoided lease costs will reach a break-even point at 7.5 years. In the analysis of the payback period, HCPS compared renting an equivalent amount of space vs. the lease-leaseback option. Remaining in the existing facilities was not an option due to their deteriorated condition. The new administration building was designed to achieve a LEED (Leadership in Energy and Environmental Design) silver certification. (A Powerpoint presentation on this project is available on request)

- Last year, Harford County Public Schools considered proposals to exchange or lease a small board of education property that is inappropriate as a vehicle storage and maintenance site but is well positioned for commercial development in the Bel Air area. In exchange, the school system was to receive an alternative site for its vehicle maintenance functions, possibly with a substantial cash consideration and site improvements. We understand that this project has not moved forward at this writing because of issues related to the design of stormwater management facilities.
- *Frederick County Public Schools (FCPS)* will not use any alternative financing approach in the foreseeable future to build a school facility: they wrote in August 2005 that “public financing is judged to be least expensive for long term project financing.” However, the school system has issued a request for qualifications for design build offerors for a proposed central administration office in the City of Frederick that will consolidate functions now housed in four inefficient buildings located several miles apart. Although Frederick County did not want to issue debt for the project, the County and Board agreed that the new administrative building could be funded through the Board’s operating budget.

An original concept, in which a developer would build and lease the facility to the Board, was rejected because the developer would not have access to tax-exempt debt and the property would be subject to real property taxation. Instead, the Board will execute a tax-exempt lease-purchase agreement that will fund land acquisition from the City of Frederick, construction of the project, contingencies, and costs of closing. The Board will ground lease the land for 40 years to the selected lease provider, which will in turn leaseback the land and the building, once constructed, for 25 or 30 years to the Board. The transaction will be structured as a conditional purchase agreement, whereby the Board will own the property at the end of the 25 or 30 years. Purchase installments, which will be considered a current expense of the Board subject to non-appropriation and not as debt, will have a principal and interest component. The interest will reflect tax-exempt rates that are approximately 30-40 basis points over general obligation debt, due to the non-appropriation risk and the illiquidity of the lease purchase agreement.

Advantages that FCPS sees in this arrangement are:

- The 40-year ground lease enables the lease provider to realize the economic value of the property in the event that the Board of Education does not appropriate funds to make the purchase installments.

- The arrangement overcomes several obstacles, including County constraints on issuance of debt for the administration building, the inability of the Board to issue debt on its own or secure real estate with a deed of trust, and the requirement of the Board and the County that payments fall within preconceived limits.
- While the interest component of the purchase installments is above what the County would have paid had it agreed to issue general obligation debt, issuance costs are lower. In addition, the occupancy cost will be significantly lower than if a developer had built and leased the building directly to the Board of Education.

When the initial design-build RFQ process is complete in September 2006, qualified offerors will be issued an RFP asking for a project proposal. The selection will be based on the technical and fee criteria. Following the selection of the design-build firm, FCPS will solicit for financing for the lease/leaseback financing arrangement described above.

- *Montgomery County Public Schools (MCPS)* is involved in non-binding preliminary negotiations with private developers to relocate an outdated and inadequate Central Warehouse Facility from a residentially zoned section of the Rockville Town Center to a new proposed industrial park. The development value of the current warehouse site is estimated to be sufficient to offset the purchase for the new location as well as approximately 75% of the cost of the new facility. MCPS is working with the City of Rockville on the zoning density for the warehouse property, which affects several neighborhood sector plans. If the sector plans are approved with sufficient density to make this proposal attractive from a financial perspective, MCPS will consider moving forward with the process to reach a formal agreement with the appropriate governmental agencies and with a private partner to relocate the existing warehouse.

Alternative Funding

Three school districts, all of which express no current interest in alternative financing, are using or exploring alternative *funding* mechanisms to build public school facilities. In alternative funding, construction monies are provided from a third source – private developer, private foundation, or non-profit organization – to replace part or all of the local obligation for a project. The county may use conventional general obligation bond revenues for the balance of their obligation, and the project is procured and delivered through conventional means, with the addition of State funds if the project is approved through the CIP process. Three current examples are provided below:

- *Anne Arundel County Public Schools* and the county government investigated using a lease-back arrangement for the construction of a replacement elementary school, but then decided to build the school using conventional financing, but with substantial donations from two residential developers. The facility planner indicates that they are receptive to exploring alternative financing methods in the future.

The LEA and county government are currently in discussions with developers over the construction of additions to two elementary schools. The developers wish to contribute the cost of the additions in order to provide the capacity that will allow them to proceed with residential construction under the county's Adequate Public Facilities Ordinance (APFO).

- *Frederick County Public Schools* currently has three projects in development that are using alternative funding sources:
 - A wing for a new high school is being funded entirely by a private developer to allow housing projects to move forward against an APFO restriction. The project will be designed and procured according to FCPS standard methodologies.
 - An earth-space science laboratory is being partly funded through private donations.
 - An addition to a middle school is receiving partial funding from a developer. To stay on schedule, the county funded and the school system built the addition even in the absence of State planning approval. The developer will pay the interest for up to seven years on the funds that the County borrowed to substitute for the State share it anticipates it will eventually receive. If State funds are not received at the end of seven years, the county will assume the interest payments.
- *Garrett County Public Schools* has received planning approval and construction funding for an addition to Grantsville Elementary School that will include spaces for both kindergarten and a Head Start program, the latter portion of the addition funded by a federal Community Development Block Grant (CDBG) secured by Community Action, a local non-profit entity. This approach mirrors projects carried out elsewhere that used funds from public sector entities or non-profits, e.g. the Maryland-National Park and Planning Commission in Prince George's County, to build facilities that provide services to the public in the same facility that houses a school.
- *Washington County Public Schools (WCPS)*. In 2002 a community group approached WCPS to build a stadium and track for North Hagerstown High, which did not have a stadium and shared facilities with South Hagerstown High School. The community group obtained \$3,500,000 in pledges and donations for design and construction costs in the form of funds and in-kind donations from private and corporate donors, contractors and suppliers, the State's Program Open Space program, the City of Hagerstown, and State general obligation bond proceeds (outside of the Public School Construction Program). On the basis of pledges for future and periodic donations secured by the community group, the County Commissioners have provided interim cash flow and financing for the project.

The project, now in construction, will be delivered through a Construction Management Agency method using competitive sealed bidding of trade contractors. Using this project as a model, the Board is encouraging other community groups to develop similar cooperative projects.

Project Procurement

Competitive sealed bidding remains the preferred procurement method among the LEAs for construction services. The major drawbacks of the method are, first, the potential for costs submitted on bid day to be substantially higher than the budget allows, and second, that a bidder who has not adequately covered the project scope will have a strong incentive to reduce quality during construction. Both problems increase during a time of rapid construction escalation, since the bidder must shoulder enormous cost risks, particularly in items or systems that have volatile pricing, e.g. petroleum-based products, or that have very long lead times, e.g.

mechanical equipment and windows. However, the procurement method has a relative simplicity, objectivity and a transparency that continues to make it attractive.

A number of jurisdictions have embraced the multi-step sealed bid process, which requires the bidders to pre-qualify for the specific project, often in addition to a general pre-qualification that applies to all projects. Short-listed constructors can then submit bids for the project. This approach typically results in a higher quality of bidder and consequently less risk to the owner. School systems that use this method report a high level of satisfaction with the results, and the PSCP actively promotes the use of the approach whenever it is realistic and will not result in a reduction in contractor interest.

Meanwhile, competitive negotiation continues to be the preferred method of obtaining professional design and construction management agency (i.e., not at-risk) services. We are not aware of any procurement of construction services that utilizes competitive negotiation. Likewise, although interest is expressed in quality based selection (QBS), no school system has undertaken to develop the procedures needed for this approach. It is possible that the procedural complexity of these two approaches, as well as the introduction of elements in the procurement process that could be attacked as subjective, have placed them practically out of reach for the LEAs.

Project Delivery

General Contracting (GC) remains the preferred project delivery method for public school construction. It is appropriate for straightforward projects in which the design is fully complete on bid day and there are no unusual schedule, site logistic, or construction demands. The simplicity of having a single point of responsibility and of knowing all costs on bid day recommends this method.

Construction Management Agency (CMA), in which the LEA holds multiple trade contracts but engages a professional construction manager to provide pre-construction advice and management services during construction, has in the last eight to ten years become a conventional project delivery approach for Maryland public schools. The method continues to gain ground, even in remote parts of the state where the increased staff involvement that this method requires is not readily available. The reason for this change lies, we believe, in the extraordinary number of bidding opportunities in the private and federal sectors that are now available to GCs in the Washington-Baltimore region, often making it difficult for school projects in general, and school projects in remote areas in particular, to receive sufficient competition. Since CMA allows local trades to bid directly on projects, the owner and CM can reach out to small contractors who otherwise would only participate through a general contractor. Depending on the local capacity in a particular trade, the results have been very mixed, but the method also allows the owner to re-bid when the initial solicitations for a specific trade package do not develop sufficient competition.

Construction Management At-Risk (CMR), in which a construction management entity offers a Guaranteed Maximum Price (GMP) before construction documents are complete, has been used successfully in the private sector where negotiated contracts are the rule. The method allows the owner to work with the constructor to arrive at a scope of work that meets both performance objectives and the owner's project budget. This approach works best if the GMP can be negotiated between the owner and the CM. A modified form of the approach, in which the LEA procures certain major trades independently and then assigns them to the CMR as part of the GMP, is now being used on selected projects by Montgomery County Public Schools.

Design-Build (DB), in which a single entity is responsible for both design and construction of the project, has been used for small projects, e.g. replacement of a portion of a mechanical system or a science classroom renovation. No large school construction project in Maryland has been carried out using DB. This is partly due to the increased management responsibilities placed on the owner, requiring qualified owner staff or contracted outside services. In addition, there are on-going concerns about releasing control of the design process to an entity other than the owner's architect, who serves as an independent check on the constructor. In a 2005 experience, the constructor wing of the DB entity refused to honor its initial cost estimate because of cost escalation, and withdrew from a project. Since a performance bond is not normally in effect for the pre-construction part of the DB process, the LEA in this situation had no recourse but to convert the project to a conventional general contracting approach. This failure of the DB to deliver as promised has had a considerable negative impact on the project schedule, and the experience stands as a warning about a potential vulnerability in the DB process.

Job Order Contracting (JOC), in which a constructor bids only on the overhead and profit associated with an extensive fixed-price list of construction items, has been used successfully for smaller projects by several LEAs.

CONCLUSION

The private sector has been active in the two years since enactment of the Public School Facilities Act of 2004 in soliciting the interest of school boards and county governments to use alternative financing arrangements. To date, the response of the LEAs has been largely tentative: many are interested, but they want to see a successful project completed in another jurisdiction before they are willing to engage in the complexity and risk of developing their own procurement. In the last year, interest on the part of both the LEAs and the private sector entities appears to have shifted away from schools and toward the construction of central administration facilities.

On the other hand, the liberalized procurement methods made available by the Public School Facilities Act of 2004 appear to have considerable attraction for the LEAs. The ability to negotiate scope and price when justified by circumstances opens the field of public school to the design-build and construction management at-risk project delivery methods which have been used successfully in the private sector. Through these techniques and through access to potential private capital, the range of tools available to school districts and county governments to meet their school facility needs has been greatly expanded by enactment of the Public School Facilities Act of 2004.

APPENDICES

A. Alternative Financing Subcommittee, Task Force to Study Public School Facilities

- Dr. David Lever, Chair, Executive Director, Public School Construction Program
- Ms. Jan Gardner, County Commissioner Frederick County Board of County Commissioners
- Dr. Nancy Grasmick, State Superintendent of Schools
- Mr. David Harrington, Member, Prince George's County Council
- Senator Patrick J. Hogan
- Mr. Roy Kirby, President, Roy Kirby Construction, Inc.
- Mr. Brian Morris, Member, Board of School Commissioners, Baltimore City Public Schools
- Mr. Daniel Smith, private environmental consultant
- Dr. Yale Stenzler, former Executive Director, Public School Construction Program
- Mr. Konrad Wayson, Member, Board of Education, Anne Arundel County Public Schools
- Mr. Tim Woodring, Member, Board of Education, Allegany County Public Schools

B. Senate Bill / 787House Bill 1230: Public School Facilities Act of 2004

Public School Facilities Act of 2004 Article - Education

Provisions on Alternative Financing and Project Delivery

4-114.

(a) All property granted, conveyed, devised, or bequeathed for the use of a particular public school or school system:

(1) Except as provided in subsection (c) of this section, shall be held in trust for the benefit of the school or school system by the appropriate county board; and

(2) Is exempt from all state and local taxes.

Money invested in trust for the benefit of the public schools for any county or city is exempt from all state and local taxes.

(c) (1) A private entity may hold title to property used for a particular public school or local school system if the private entity is contractually obligated to transfer title to the appropriate county board on a specified date.

(2) The conveyance of title of school property to a private entity for a specified term under this subsection may not be construed to prohibit the allocation of construction funds to an approved school construction project under the Public School Construction Program.

(3) A county or county board may convey or dispose of surplus land under the jurisdiction of the county or county board in exchange for public school construction or development services.

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(a) In this section, "alternative financing methods" includes:

(1) Sale-leaseback arrangements, in which a county board agrees to transfer title to a property, including improvements, to a private entity that simultaneously agrees to lease the property back to the county board and, on a specified date, transfer title back to the county board;

(2) Lease-leaseback arrangements, in which a county board leases a property to a private entity that improves the property and leases the property, with the improvements, back to the county board;

(3) Public-private partnership agreements, in which a county board contracts with a private entity for the acquisition, design, construction, improvement, renovation, expansion, equipping, or financing of a public school, and may include provisions for cooperative use of the school or an adjacent property and generation of revenue to offset the cost of construction or use of the school;

(4) Performance-based contracting, in which a county board enters into an energy performance contract to obtain funding for a project with guaranteed energy savings over a specified time period; and

(5) Design-build arrangements, that permit a county board to contract with a design-build business entity for the combined design and construction of qualified education facilities,

including financing mechanisms where the business entity assists the local governing body in obtaining project financing.

(b) Except when prohibited by local law, in order to finance or to speed delivery of, transfer risks of, or otherwise enhance the delivery of public school construction, a county may:

- (1) Use alternative financing methods;
- (2) Engage in competitive negotiation, rather than competitive bidding, in limited circumstances, including construction management at-risk arrangements and other alternative project delivery arrangements, as provided in regulations adopted by the Board of Public Works;
- (3) Accept unsolicited proposals for the development of public schools in limited circumstances, as provided in regulations adopted by the Board of Public Works; and
- (4) Use quality-based selection, in which selection is based on a combination of qualifications and cost factors, to select developers and builders, as provided in regulations adopted by the Board of Public Works.

(c) The Board of Public Works shall adopt regulations requiring a project that qualifies for alternative financing methods under this section to meet requirements regarding the advantages of the project to the public that include provisions addressing:

- (1) The probable scope, complexity, or urgency of the project;
- (2) Any risk sharing, added value, education enhancements, increase in funding, or economic benefit from the project that would not otherwise be available;
- (3) The public need for the project; and
- (4) The estimated cost or timeliness of executing the project.

(d) Projects that qualify for alternative financing methods under this subsection:

- (1) Shall meet the educational standards, design standards, and procedural requirements under this article and under regulations adopted by the Board of Public Works; and
- (2) Consistent with the requirements of this article, shall be approved by:
 - (i) The county governing body;
 - (ii) The state Superintendent of Schools; or
 - (iii) The Interagency Committee on School Construction and the Board of Public Works.

(e) Use of alternative financing methods under this section may not be construed to prohibit the allocation of state funds for public school construction to a project under the Public School Construction Program.

(f) A county board may not use alternative financing methods under this section without the approval of the county governing body.

(g) The Board of Public Works shall adopt regulations recommended by the Interagency Committee on School Construction to implement the provisions of this section, including:

- (1) Guidelines for the content of proposals, for the acceptance and evaluation of unsolicited proposals, and for accepting competing unsolicited proposals;
- (2) Requirements for the content and execution of a comprehensive agreement governing an arrangement authorized under this section;
- (3) Guidelines for content and issuance of solicitations;
- (4) Requirements for the prequalification of bidders or offerors;
- (5) Requirements for public notice of solicited and unsolicited proposals and proposed execution of a comprehensive agreement;
- (6) Regulations that require compliance with requirements applicable to qualified projects that would otherwise be in effect under the state procurement law if the procurement were competitively bid; and
- (7) Regulations that require that contracts and subcontracts adhere to the requirements of title 17, subtitle 2 and title 14 of the State Finance and Procurement Article *if the requirements would otherwise be applicable.*

C. Workgroup on Project Procurement, Delivery, and Alternative Financing

- Dr. David Lever, Chair, Executive Director, Public School Construction Program
- Mr. Adam Zimmerman, Vice-Chair, Program Manager, Public School Construction Program
- Mr. Donald Arnold, Member, Board of Education, Baltimore County Public Schools
- Dr. William AuMiller, Superintendent, Allegany County Public Schools
- Mr. Ray Barnes, Executive Director, Frederick County Public Schools
- Mary Jo Childs, Esq., Counsel, Board of Public Works
- Mr. Bernard Fox, Supervising Budget Examiner, Department of Management & Budget
- Ms. Jan Gardner, County Commissioner, Frederick County Commissioners
- Mr. Dick Hawes, Director, Facilities Management, Montgomery County Public Schools
- Mr. Carl LaVerghetta, Director of Procurement, Department of General Services
- Mr. Rupert McCave, Capital Improvement Program Officer, Prince George's County Public Schools
- Sheila McDonald, Esq., Executive Secretary, Board of Public Works / Treasurer
- Mr. Gary McGuigan, Project Director, Maryland Stadium Authority
- Mr. Mark Moran, Facilities Planner (retired), Anne Arundel County Public Schools
- Mr. John O'Neill, Director of Administration, Harford County Government
- Elizabeth Roese, Esq., Director, Public Finance, Office of the Attorney General
- Dr. Bernard Sadusky, Superintendent, Queen Anne's County Public Schools
- Elliott Schoen, Esq., Assistant Attorney General, Office of the Attorney General
- Dr. Beatrice Tignor, Chair Board of Education, Prince George's County Public Schools
Director of Procurement, Montgomery County Government
- Dr. Jerry Weast, Superintendent, Montgomery County Public Schools

D. Regulations Workgroup

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