

MEETING THE NEED FOR SCHOOL CONSTRUCTION

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

SUPPLEMENT TO THE REPORT OF OCTOBER 3, 2011

SUBMITTED TO THE BOARD OF PUBLIC WORKS

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September 2, 2014



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Since the Interagency Committee on School Construction (IAC) submitted its last full report in October 2011 on alternative financing, procurement, and project delivery of public school facilities in Maryland, exploration of the subject has continued. The following report is presented as an update to the October 2011 report.

September 30, 2013, December 13, 2013, and August 22, 2014: Lieutenant Governor Subcabinet on Public Private Partnerships, Annapolis, MD

The IAC serves as a member of the Lieutenant Governor's Subcabinet on Public Private Partnerships (P3). Discussions with MEDCO, MDOT, the University system, and the Maryland Stadium Authority (MSA) have been helpful in understanding their projects, and in further exploration of the potential for application of P3 arrangements to school construction. Since the IAC is working closely with MSA on the Baltimore City 21st Century School program, it is likely that any venture into the schools P3 arena will be done in collaboration with MSA.

Summer 2014: Governor's Executive Order on the Funding and Financing of Public School Construction

On May 6, 2014, Governor Martin O'Malley issued an Executive Order charging the IAC, in collaboration with the Department of Budget and Management and the Department of Legislative Services, and with input from the State Treasurer's Office, local boards of education, and local governments, to study creative means of increasing funding, creating more reliable revenue streams, and use of "lease payments or other alternative financing methods for public school construction." A final report on the study is due in September 2015.

Among the alternative financing methods that will be considered in the study, public-private partnerships of two fundamental types are under examination in the context of the Baltimore City 21st Century School Plan:

- 1. Leveraging of Assets.** In this approach, a school system or local government leverages an existing asset in order to develop an income stream to pay for school improvements. The most significant example of this approach is the Oyster School in Washington D. C., completed in 2001. Approximately half of the original 1.67 acre Oyster School site was sold for the construction of a high-rise apartment building. The sale proceeds from the property and the taxes from the residential units are used to repay the \$11 million construction and financing costs for a new structure that has replaced the original, obsolete Oyster School facility.¹ Certain characteristics of the school contributed to the success of this project:

¹ 21st Century School Fund, "Building Outside the Box. Public-private partnership: A strategy for improved public school buildings"

- **Location.** The school site is at the corner of Calvert Street and Cleveland Avenue in northwest Washington, an area of premier residential units, within walking distance of the restaurants and shops, the Red Line Metro stop, and the bus stops of Connecticut Avenue. The site is also within walking distance of Dupont Circle and has almost immediate access to Rock Creek Park. In the Washington realty market, there is little risk that the condominium units in the new apartment building will fail to sell or develop the revenue stream needed to repay the capital investment.
- **Community.** The school community was educated and affluent, and it possessed the stability and staying power to see the eight-year process of developing the financing arrangement for the school through to a successful completion.
- **Advocates.** The community had access to the expertise of the 21st Century School Fund, a nationally recognized non-profit that focuses on a range of school facility issues, and startup grant funding from the Ford Foundation.

On April 25, 2014, Baltimore City Public Schools, the Stadium Authority and the IAC jointly hosted a tour of three school sites in Baltimore City that appear to have leveraging potential. A group of officials from the State, the Maryland Stadium Authority, City Schools, and the City of Baltimore, joined by representatives of the KPMG investment advisory group, walked through the school facilities and became acquainted with the surroundings. All three locations are of interest to the City of Baltimore for their redevelopment and revitalization potential. The three sites are:

- a. **Westside Skills Center.** This former department store now serves as the career and technology education (CTE) facility for Edmonson High School, which is separated from the Skills Center by a residential street. The Skills Center will be abandoned when Edmonson High is replaced, now scheduled to occur in Year 5 of the 21st Century Schools program. The Westside facility abuts the Uplands residential development on Edmonson Avenue, is across the street from a shopping plaza, and most important, will be well located in relation to a future Red Line subway stop.
- b. **Eutaw-Marshburn Elementary School.** This school occupies a 3.6 acre site that includes a community recreation center owned and operated by the City. The site sits on a developmental divide: on the east side of Eutaw Place is Bolton Hill, a handsome area of renovated residences and home to the Maryland Institute College of Art (MICA); on the west side of the street is a struggling zone of dilapidated or abandoned townhomes that are generally structurally sound, some housing projects, and a lack of physical amenities. The 21st Century Schools Plan calls for the Eutaw Marshburn School to be renovated or replaced in Year 3, with a possible reduction in size.
- c. **City Springs Elementary / Middle School.** This facility, indicated to be renovated or replaced in Year 3 of the Plan, is located a few blocks south of the Johns Hopkins East Side Medical Center and a few blocks east of Little Italy. The site has considerable future potential as the Medical Center grows.

While none of these sites has the clear locational and other advantages enjoyed by the Oyster School in Washington, they do have long term potential for private sector interest,

either through an entirely private use of the site to develop the revenue stream needed for renovation or replacement of public schools, or through a joint-use of the site similar to the Oyster approach. The alignment of three factors could make these projects viable: city investments in physical infrastructure and social programs that will improve both the perception and the reality of the sites; the actual schedule for replacement or renovation of the school facilities; and private sector pressures on housing and commercial space that will generate a market interest in the advantages of the sites.

2. Availability Payment Model

The United Kingdom, Canada, Australia, and other countries in the English-speaking world, as well as nations elsewhere, have developed sophisticated methods for engaging the private sector in the design, construction, financing, maintenance and operation of public infrastructure. The method (typically called Design-Build-Finance-Maintain-Operate, or DBFMO) transfers the risks associated with project scheduling, construction, and maintenance and operations to the private vendor, who is repaid through an availability payment over the term of the contract, typically 25 to 30 years. The vendor is held to defined standards of maintenance and operations, with penalties that can be levied if the standards are not met. The decision to use the DBFMO method is based on a Value for Money (VfM) analysis, in which the alternative private approach is compared to the standard public sector approach (the Public Comparator) to determine if efficiencies in project execution or in maintenance and operations will offset the increased financing costs that the private vendor will carry.

While the availability method has had application to transportation and port projects, where a clear revenue stream can be identified for repayment of the capital outlays, the last two decades have seen the method extended to social infrastructure, including schools. The U.K. has carried forward an ambitious program to rebuild virtually all of its schools; although the program was halted by the Cameron Government in 2010, we understand that it has been revived under a new management structure. Alberta, Canada has used the DBFMO method to undertake 35 new schools to address rapid enrollment growth associated with the shale-oil industry. In the United States, the Long Beach, California, Courthouse is the first major project to be developed under an availability payment approach; this project opened in 2013. In the K-12 facility arena, only Yonkers, New York has considered application of the method, and evidently the program has been halted pending resolution of legal and cost issues.²

Maryland's jurisdictional structure and educational facilities challenges are quite different from those of Alberta, the North American jurisdiction that has carried out the DBFMO program for educational facilities at a large scale. As the provincial government, Alberta provides the largest component of school construction funding, so that local educational authorities take guidance from the province with respect to design and project scope. Subject to regulation, in Maryland the local boards of education exercise considerable autonomy with respect not only to their educational programs and the facility designs that support these programs, but also in the procurement and execution of their projects. Moreover, except in a few jurisdictions, the economic recession has led to a slowing or even decline of enrollment growth, so that the major task faced by school systems is the renewal of their existing plant rather than the construction of new facilities. From the perspective of

² Commission of Inquiry into the Finances of the City of Yonkers, "Report on the 'PRIDE' Proposal of the Yonkers School Board," July 10, 2013

private sector vendors in the DBFMO market, new construction is most attractive because it presents the least risks associated with latent conditions that could affect the cost of construction or the long-term maintenance and operations performance of the building.

Given these constraints, the 21st Century School program in Baltimore City is attractive to be considered under an availability payment method. Since the City Schools projects are within a single jurisdiction, they are subject to a single set of educational parameters, design standards, and procurement methodologies. The projects will be carried out in waves, presenting opportunities for bundling of design, materials, construction trades, and other factors that will reduce costs. And the program will include an estimated 15 replacement schools, which have the characteristics of new construction.

Next Steps

In meetings subsequent to the Baltimore City P3 tour, MSA and IAC staff agreed that while both models are well worth looking into for delivery of some of the Baltimore City 21st Century School projects, the primary focus for the present should be implementation of the 12 school projects in Year 1 of the Plan using conventional methods. Many methodological, scope, design, and maintenance issues have been resolved among the four parties to the Memorandum of Understanding since passage of HB 860 in the 2013 legislative session, but other issues are under discussion and will affect the timelines for carrying out the projects. Once the scopes, schedules, and budgets for this first wave of projects are well-established over the next 12 to 18 months, MSA and IAC will explore the potential for application of P3 concepts to schools in Years 2 and 3 of the Plan.