Bond Case Briefs

Municipal Finance Law Since 1971

Howard County Courthouse P3.

Key project features

Howard County, Maryland ("County") is implementing a public-private partnership for the design, construction, and operation of a new courthouse. A bidding process would be used to secure a private consortium to execute a single P3 Contract with County covering the required services. A combination of public and private financing would fund design and construction costs. The County issued a Request for Expressions of Interest "EoI" which indicates a procurement schedule leading to statements of interest being submitted in September, with short-listed respondents being selected in October, to receive an RFP in November.

Background

Located halfway between Washington D.C. and Baltimore, the County is a bedroom community for those cities and is also a major commercial center for the region. It is one of the state's fastest growing counties; since 1983 its population has increased over 140%. It is the third wealthiest county in the nation. The County's general obligation bonds are rated "AAA" by Moody's Investor's Service, Aaa by S&P Global Rating and "AAA" by Fitch Ratings.

Courthouse Status

The existing County courthouse is over 170 years old and cannot accommodate a cost effective expansion. The project would provide a modern and secure circuit courthouse to meet current and future judicial requirements. The estimated capital costs of the project are US$138,730,000.

Schedule

In 2016, a Circuit Courthouse Program of Requirements and master plan were established. Project research and analysis was undertaken by the Spending Affordability Advisory Committee, a group comprised of Howard County citizens, organizations, and government officials.

In March 2017, the approval of Resolution No. 27-2017 confirmed support of the project from the Howard County Council and County Executive.

General obligation bond issuance has been approved to cover anticipated milestone payments, as well as procurement and preparatory costs. Financial, legal, and technical advisors have been contracted.

Following the issue of the RFP in November (as indicated above) the schedule will be as follows:

— Dialogue with the top three shortlisted bidders will be used to further develop the RFP Proposal Responses in November to December 2017

— Interim submittals due in January 2018

— Final proposals due in April 2018

— Selection of preferred proposer in September 2018

— Commercial and financial close in November 2018

County Powers

Howard County is a charter county with express home rule powers granted under Maryland law. Its charter was adopted under Article XI-A of the Maryland Constitution, which is known as the Home Rule Amendment. Under the Express Power Act (now codified at Article 10 of the Local Government Article of the Maryland Code), the General Assembly has endowed charter counties with a wide array of legislative and administrative powers over local affairs. Maryland courts have characterized the Express Powers Act as an expansive grant of authority and liberally construed these powers. The Express Powers Act explicitly grants the power to establish and maintain courthouses and confers broad powers over county property. Under the County Charter, the County may enter into multi-year contracts for services.

The P3 Contract is likely to be subject to annual appropriations to avoid being characterized as debt. Given the County's stellar credit a "subject to annual appropriation" clause in the P3 Contract should not impair the bankability of the project. The Court has already entered into equipment leases with these clauses.

Since general obligation bond financing is part of the proposed delivery model, the P3 Contract term would be limited to 30 years to comply with the IRS management contract rules applicable to tax-exempt debt.

P3 Evaluation Process

The County's Spending Affordability Advisory Committee evaluated alternative delivery methods (including a conventional County procurement of design and construction services) using a comparison of life cycle costs in order to determine the optimal value for money. The Committee balanced costs, risks, and completion certainty, among other factors.

The Committee singled out several advantages of a P3 over conventional approach. A long-term P3 contract structure incentivizes lowest life cycle costs by allowing the P3 developer to make trade-offs with a long-term, lifecycle cost interest in mind. Conventional contract structures (often using a series of contracts) instead focus competition on lowest capital costs and are likely to result in higher lifetime costs.

Contractual structure allows for innovation through output-based specifications which permit more creative solutions than conventional contract structures, which stifle innovation through input based specifications.

Transferring risks to the private sector is likely to lead to better risk management by the private sector than conventional contract structures which leave risks with the public sector.

It was recognized that the cost of private financing in the selected model is inherently more expensive than general obligation bonds, so general obligation bond proceeds will fund a significant part of the capital costs.

The Committee concluded that the selected delivery model provides incentives for the private partner to "achieve cost savings, improve quality, and effortlessly transfer risks." The delivery model provides more cost certainty for the lifetime cash flow. The delivery model provides earlier completion than a conventional procurement.

Hybrid P3 Model

The selected delivery model was characterized as a "Hybrid P3"; it provides for a design, bid, build, operate, and maintain P3 Contract using public and private financing to fund construction costs. The County would issue 30 year general obligation bonds to fund the milestone payment to be made on completion of the project. The EoI states that this payment will be in the order of US$90 million. That milestone payment will only cover part of the construction costs and a selected contractor would fund the rest through private financing. The goal of the private funding is to assure that the contractor have "money at stake" in relation to the whole-life operation of the courthouse.

Once the project is complete and accepted by the County, the indication is that the County plans to take a more or less conventional approach to making periodic availability payments under the P3 Contract to the private contractor, with deductions being made for suboptimal performance (falling short of "non-availability") and larger deductions for non-availability. Under the P3 Contract, "availability" would be expected to be limited to the elements that are the most important to overall provision of the specified services.

The P3 contract is also expected to take a conventional approach to handback requirements consistent with: (1) the specified design life requirements and the useful life standards; and (2) the private contractor having met its contractual obligations for the operating services.

The full Howard County Courthouse EoI can be found here.

Hogan Lovells – Mike Matheou and Edward C. Sledge

USA July 19 2017