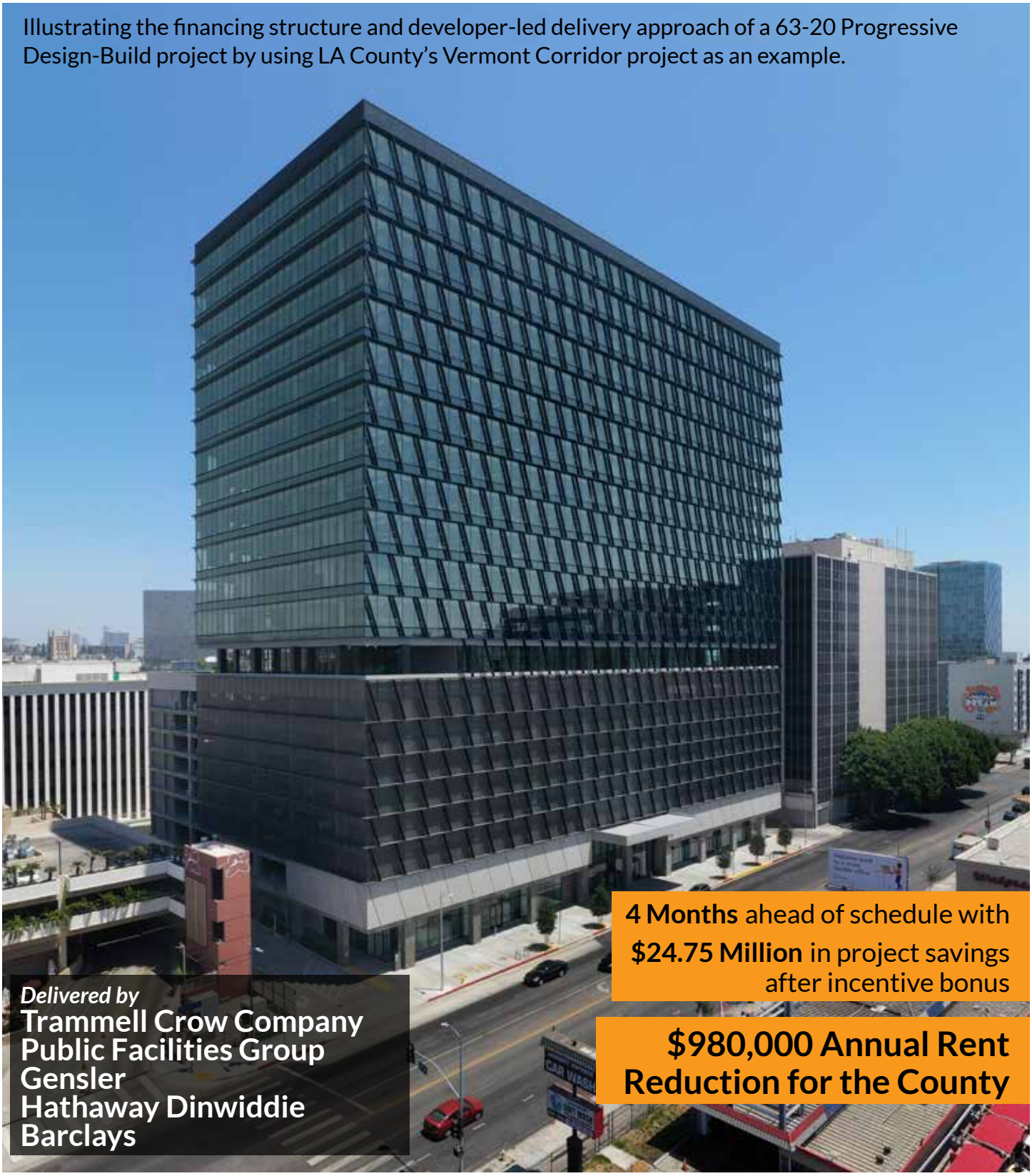
PFG
Public Facilities Group

A CASESTUDY

The County of Los Angeles' 63-20 PDB Project

Illustrating the financing structure and developer-led delivery approach of a 63-20 Progressive Design-Build project by using LA County's Vermont Corridor project as an example.



4 Months ahead of schedule with
$24.75 Million in project savings after incentive bonus

$980,000 Annual Rent Reduction for the County

Delivered by
Trammell Crow Company
Public Facilities Group
Gensler
Hathaway Dinwiddie
Barclays

Vermont Corridor County Administrative Offices

The new $345 million building for Los Angeles County is a 21-story administrative office facility and parking garage. The LEED Gold building is 13 stories of office building that sits on top of an 8-story parking structure. An additional 10-story parking structure is being built adjacent to the new office building.

The project was completed in October 2021, 4 months ahead of schedule and with $24.75 million in project delivery savings, despite the unusual challenges presented by unprecedented federal tariffs and a global pandemic. The County elected to defease bonds with the unused portion of funds, reducing the County's rent obligation by $980,000 per year, effectively saving the County $32,340,000 in rent payments over the 33-year term of the debt. The project also reduced the County's original project budget by $30 million because the estimated project timeline of a 63-20 Progressive Design-Build was 11 months faster than the County's original CMAR approach.

During predevelopment, Gensler (Architect) and Trammell Crow Company (Developer) discovered the County's prescribed square foot per employee number was beyond the current industry standards for office buildings. By re-assigning a market standard square feet per employee, the development team was able to further reduce the project costs by $30 million. Instead of reducing the project budget, the County decided to keep the existing footprint to increase available administrative space for use by other County departments.

Why 63-20 bonds vs Lease Revenue Bonds or Conventional Debt and Equity?

The term 63-20 refers to the 20th IRS revenue ruling in 1963. The revenue ruling gives a not-for-profit organization the ability to issue tax exempt bonds (i.e., bonds the interest on which is not subject to federal income tax) to finance exempt facilities. The revenue ruling was further clarified in Revenue Procedure 82-26. The model has been widely used in the U. S. for funding Public-Private Partnerships and is best defined as the 63-20 Progressive Design- Build approach. PFG recently used this structure for the successful delivery of the Salinas, California Police Service Headquarters and the Salinas El Gabilan Library. Trammell Crow and PFG's staff jointly employed the model on the Riverside County Law Building in Indio, California, the Gateway at Alhambra project for the County of Los Angeles and most recently the Vermont Corridor project.

Because of certain restrictions on the use of general obligation bonds, most California jurisdictions look to lease revenue bonds to finance new facilities. While all lease revenue bond structures use a long-term lease with a governmental tenant as the principal source of security and repayment, they may differ greatly in how they employ and manage construction financing, risk transfer, incentives to achieve and capture cost savings for public agency lessees, long term repair and maintenance, and final transfer of ownership. The 63-20 Model offers an attractive set of public protections in each of these areas. In addition to the more practical concerns of faster project delivery and reduced financing costs, the County of Los Angeles chose to use 63-20 bonds for the Vermont Corridor project because they offered certain safeguards not available in either lease revenue bonds or in conventional debt and equity structures commonly used in Privately-Led P3 delivery models.

The most important feature in 63-20 transactions is that the governmental entity "on whose behalf" the project is undertaken must have the right to repay the debt at its sole discretion, and by doing so, receive at no cost, the unencumbered fee title to the financed facility. This is an important safeguard that enables 63-20 transactions to avoid the unwind difficulties that some jurisdictions have experienced in other forms of P3 delivery.

Additionally, as seen in Alhambra, in Riverside County, in Salinas and most importantly in the Vermont Corridor financing, there are no negative impacts on bond pricing or bond ratings when comparing appropriately structured 63-20 bonds to traditional governmental lease revenue bonds. In all the above-mentioned projects, the 63-20 bonds were rated and priced on par with other City and County-Led lease revenue bond financings.

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This dramatically differs from privately-led lease revenue bond financings and conventional debt and equity structures favored by many P3 models. These privately-led lease revenue bonds are normally viewed as project financings, as opposed to municipal financings. Project financings tend to be rated at the lowest investment grade by rating agencies, and if they have equity equivalent features, those "equity" tranches are commonly rated below investment grade. The Vermont Corridor project was rated equal to the County's own lease revenue bonds at AA with a positive outlook by S&P and as AA- by Fitch.

Unlike most governmental lease revenue bond financings, the Vermont Corridor project did not require a debt service reserve. The absence of a debt service reserve did not negatively impact either the bond rating or the bond pricing. These issues achieved bond rates significantly below Privately-Led lease revenue bond financings and dramatically below rates achieved in blended debt and equity financed structures.

Why an Independent Not-for-Profit Owner vs. a Joint Powers Board and Publicly-Led Process?

In the development model used for the Vermont Corridor project, PFG created and staffed an independent single asset not-for-profit owner.

PFG needed to have the correct public purpose (lessening the burdens of government), be knowledgeable in real estate development and management, and be independent of the rest of the development team. PFG is the issuer of the 63-20 bonds and is responsible for preparation of the POS and other financing documents. In doing so, it is critically important that PFG coordinate closely with LA County since the credit support for the project is derived from LA County's lease obligation.

After the bonds are sold, the proceeds are held by a trustee and used to build the facility. The not-for-profit owner, PFG, hires the development team: a developer, contractor, architect, and all major sub-contractors. As the obligated party on the debt, PFG is responsible for paying back the bonds. Since the lease does not obligate LA County to pay rent until it has "beneficial occupancy" of the building, PFG must cause the building to be completed in accordance with the plans and specifications through its contracts. Without satisfactory completion of the building, there is no enforceable obligation for LA County to pay rent. Therefore, PFG must secure contractually binding completion and price guarantees from its development team.

For PFG to sell bonds to build the facility, it must complete three key steps:

(1) Engage a strong development team willing to provide a Guaranteed Maximum Price (GMP) with a date specific completion guarantee;
(2) Obtain approval of all entitlements; and
(3) Negotiate a ground lease and facilities lease effective upon substantial completion.

Because PFG can borrow only funds sufficient to build the facility, and does not have recourse to the tenant, there is no means for the development team to exceed the limits of the Guaranteed Maximum Price. In addition, since no party to a contract can successfully complete its obligations without the other party fulfilling its counterparty obligations, PFG must understand its duties and have the capacity to perform them in a satisfactory and timely fashion. To facilitate timely performance, the development agreement and the lease include specific time frames for all decisions. Without adherence to a schedule, the development team cannot complete the project on time and within budget.

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Once the project is complete, the 63-20 Model allows for a series of short-term private property managements contracts. These contracts are between PFG and the property manager and are designed around the LA County's needs. By using short term contracts, the process can introduce competitive bidding and more advantageous pricing into property management. It also allows for self-management, if LA County desires.

There are other benefits of using a publicly motivated independent not-for-profit owner (PFG). In lease revenue bond transactions, it is normal to borrow an additional six months of capitalized interest to cover force majeure and other unforeseeable events that could delay project completion. Too often in private owner-led lease revenue bond structures, this capitalized interest "cushion" is used or captured by the owner/developer. In a 63-20 transaction with an independent not-for-profit owner, this unused cushion is returned to the tenant to fund building enhancements or to retire bonds.

Similarly, for many governmental lease revenue bond issuers, it is still standard to fund a debt service reserve. During periods with a positively sloped yield curve, this structure is of questionable benefit when developing essential governmental buildings. Transactions financed with 63-20 debt do not normally employ a debt service reserve fund and have not experienced negative impacts on either their bond ratings or pricings. Debt service reserves were not included in the Vermont Corridor, or any other PFG led 63-20 Progressive Design-Build projects and there were no adverse impacts on pricing.

Finally, the structure is especially beneficial in insulating LA County from cost overrun risk. Because only PFG and the development team members are obligated parties under the development contract, there is no contractual privity running to the public tenant. After a decision was made to use this means to develop, finance and build a facility, LA County and PFG signed a lease which is the only contract between the two. Without contractual privity between the public entity and the developer, the entity is not an obligated party for cost overruns, should they occur. In contractual disputes the development team, has no recourse to the governmental tenant.

Why a Developer-Led Delivery Approach?

The Developer-Led Delivery Approach used by PFG, when implementing a 63-20 Progressive Design-Build Approach, involves a form of Integrated Project Delivery designed to bring all key project disciplines into the pre-development process as early as possible. A developer-led approach is not to be confused with a construction manager or project manager approach – the developer's role creates critical value for the project. In this case, Trammell Crow brings an exceptional track record of experience and success in developing similar facilities, both on-time and within budget.

As a recognized industry leader, the right developer brings experience, influence and clout into the design and construction process. It is this leadership that is at the heart of the Integrated Project Delivery process and is why it has developed as the most efficient form of project delivery. It allows for cross-discipline collaboration from the beginning of design and for selecting sub-contractors through the most qualified and advantageous selection processes. This approach has resulted in projects that on average are 15% to 20% less costly and are delivered 30% to 40% faster, with equal or higher quality when compared to typical publicly overseen projects.

Price is driven by the industry and who holds the contracts. With publicly-led projects, contractors always charge a premium when bidding projects. They price into their bids both a public learning curve and an expectation of time delays. By employing a developer-led integrated form of delivery with an experienced private not-for-profit

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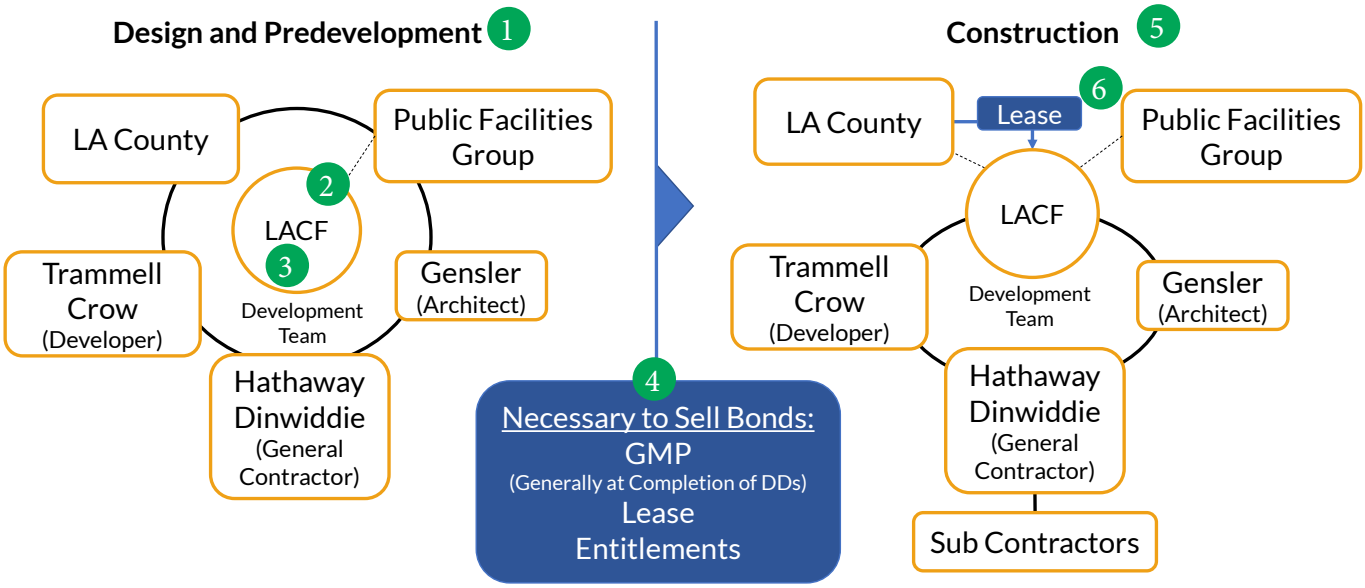
owner/financer, this reality can be changed. In the Vermont Corridor Project, Trammell Crow was able to achieve significant design improvements over the County's original specifications. These changes reflected modern office concepts and improved value and efficiency without altering the project's desired level of quality. This resulted in a $30 million cost reduction in the Predevelopment (design) Phase of the process. When coupled with another $30 million in delivery schedule savings, the process achieved a $60 million reduction over the County's original CMAR delivery approach and budget. This project cost reduction was achieved in predevelopment and does not include the $24.75 million in project savings achieved in construction.

In all forms of contracting, key team members like the developer and the contractor are paid a fee for service. This fee is a small percentage of the total value of work performed. Since neither Trammell Crow nor the contractor, Hathaway Dinwiddie, self-performs significant work, their fee is essentially structured as a percentage of the contract amount. In a typical publicly-led development approach, the process nearly always results in projects that fully exhaust their budgets, thus maximizing the fees paid to the key team members. Additionally, with the absence of an incentive structure, the typical public contracting process encourages change orders that result in increased costs and increased contractor fee revenue. By properly providing a development incentive to reduce costs and expedite delivery, this problem can be eliminated.

The Development Process for The Vermont Corridor Administrative Offices Building



1. All partners are active partcipants in the design and predevelopment phase
2. PFG created the Bankruptcy remote, not-for-profit special purpose entity, LACF
3. LACF hires the Developer, Architect and General Contractor, Trammell Crow oversees development
4. In order for LACF to sell bonds, there must be an agreed upon GMP, Lease Agreements and the approval of all entitlements
5. Construction begins, LA County continues to be actively involved in the project, but is insulated from risk and contractual privity by the not-for-profit Special Purpose Entity, LACF
6. The lease agreement is in place and will become active when LA County occupies the facility

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Central to the Developer-Led Integrated Delivery approach practiced by PFG are tightly-drawn contracts that include rewards for success, penalties for failure, and incentives for cost savings. In the Vermont Corridor project, the incentive is 33% of the first $2,000,000 in savings and 25% of any savings in-excess of $2,000,000. All savings after the incentive distribution are credited to the County of Los Angeles. The County's use of its share of project saving ($24.75 million) is limited by the tax code to project enhancements or early retirement of the bonds. The County elected to defease a portion of the bonds, lowering their debt service obligation by $980,000 annually. This incentive structure encourages the contracting teams to seek efficiencies by providing a mechanism that can increase their earnings beyond what they would achieve by simply building the project in accordance with the budget. At the same time, it benefits the tenant by lowering the overall project cost as reflected in their rental obligation. This approach is a win/win strategy that works by aligning both parties' self-interests.

In addition to employing an integrated delivery process to reward success, Vermont Corridor (as with all PFG Projects) included a penalty for failure. The development team was tasked with a design and budget target. The design was advanced through Construction Drawings in the Predevelopment Phase of delivery at which time the GMP was established with appropriately sized contingencies and a completion date. The contract disallows an increase in price beyond the GMP and limits extensions of the completion date to events of force majeure with an outside limit of 90 days. The development team is required at all times to keep the project in "balance" and if it became "out of balance" to contribute from its fees sufficient funds to return the project to balance.

Learn More

P3 Webinars

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