



## Judicial Council of California

ADMINISTRATIVE OFFICE OF THE COURTS

JUDICIAL AND COURT OPERATIONS SERVICES DIVISION

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November 30, 2012

Mr. Mac Taylor  
Legislative Analyst  
Legislative Analyst's Office  
925 L Street, Suite 1000  
Sacramento, California 95814

Dear Mr. Taylor:

RE: Maximizing State Benefits From Public-Private Partnerships, November 8, 2012

This letter is in response to specific conclusions concerning the Long Beach courthouse public-private partnership (P3) project contained in the *Maximizing State Benefits from Public-Private Partnerships* LAO report, dated November 8, 2012. The AOC concurs with the report's conclusions that public-private partnership (P3) procurement has merit and may be the best option for some of the state's infrastructure needs, especially when the state lacks the upfront funding to begin a vital construction project. However, certain statements and conclusions in the report do not accurately reflect or analyze the processes used for identifying the project as being appropriate for a P3 or the benefits to the state of the project.

The report concludes that the Long Beach courthouse was a "problematic" and "inappropriate" project for the P3 approach (*page 18*).

First, it should be noted that that the Long Beach courthouse project was legislatively authorized. SB 77, Budget Act of 2007, Item 0250-301-3037 (1.6), provision 8 provides:

[T]he Administrative Office of the Courts shall gather information for a public private partnership agreement for the Long Beach Court replacement, specify a process and criteria for developing alternative methods of project delivery, and identify variables that will be used to evaluate the alternate methods of delivery.

Pursuant to Section 70391.5 of the Government Code, the Judicial Council may enter into a lease-purchase agreement or other appropriate multi-year agreement, together with other related agreements, with one or more entities for the delivery of the new Los Angeles County – Long Beach Courthouse .... subject to notice to the Legislature and the Department of Finance approval that the agreements meet established performance expectations.

A September 14, 2012, AOC report evaluating the Long Beach project development to this point (<http://www.courts.ca.gov/documents/Long-Beach-PBI-evaluation-report-9-14-12.pdf>) describes in detail how the AOC worked closely with the Executive Branch and responded to concerns from the Joint Legislative Budget Committee and your office as we developed the performance criteria and agreements that structured this project. The AOC sought and received the required authorization of the project at several stages—in 2008, 2009, and before the agreements were finalized in 2010.

Next, the report states, “the Long Beach courthouse project lacks unique or complex features that would likely benefit from innovative design and construction techniques.” In fact, one of several reasons that the Long Beach court building made a good candidate for P3 is its technical complexity. A large trial court building such as Long Beach contains many interdependent electronic systems for security, life safety, energy management, and communications. A court building of this size contains hundreds of detention cells with specialized equipment; this building also contains 19 elevators and 2 escalators, which are necessary to move the occupants securely and efficiently. The Long Beach Court building is inherently complicated and technically challenging and a good candidate for leveraging private sector expertise through a P3.

The report also levels four criticisms related to the Value for Money (VfM) analysis performed for the Long Beach courthouse: “*VfM Analyses Based on Assumptions That Favored P3 Procurement*” (beginning on page 19).

As you know a significant period of time was taken for development of the project delivery method and the VfM analysis, both of which underwent rigorous reviews along the way with the other branches of state government. The AOC incorporated suggested changes in the assumptions, analyses, and project agreements. Additionally, industry best practices were applied

in developing several critical components of the VfM analysis. The specific criticisms are addressed below.

*VfM included Unjustified Tax Adjustment*

The tax adjustment is a part of the “competitive neutrality” component of the value for money analysis. The adjustment is included to reflect the fact that the public-private partnership option has an implicit disadvantage when compared to a traditional state procurement due to the taxes paid by the private partner. Extensive literature about competitive neutrality exists, and it is an industry standard and accepted component of VfM analyses comparing public to private project delivery options. The government in Australia has defined competitive neutrality as:

Competitive neutrality is about ensuring that the significant business activities of publicly owned entities compete fairly in the market when it is in the public interest for them to do so. It is about transparent cost identification and pricing in a way which removes net cost advantages arising from public ownership. Competitive neutrality does not apply to non-business, non-profit activities of government.

Therefore, the tax adjustment is unrelated to whether taxes directly benefit California government. Regardless of the type of taxes paid by the private sector, it is an expense not borne by the government. To simply remove the taxes paid from a VfM would not treat the two options equally.

Additionally, the \$232 million value of the tax adjustment mentioned in the LAO report represents the federal tax component in as-spent dollars over the operating and construction periods. Because the VfM is expressed in Net Present Value (NPV) terms, a more consistent expression of this cost would be its NPV, which would be in the order of \$55 million.

*Overstated Cost Overruns*

The report states that an assumed \$128 million cost overrun in a traditional state-build approach is overstated. As for the \$128 million estimate attributed to cost overruns—it is the total nominal value of all probable risks held by the state in the traditional procurement alternative calculated using a thorough structured risk analysis.

Structured risk analysis and the assignment of values of the risks retained by each party is an accepted best practice in comparative analysis of infrastructure procurement methods—for example, it is mandated by the Federal Transit and Highway Administration for projects it funds. The structured risk analysis for Long Beach was performed at three points prior to completing the VfM. In addition, at the request of the LAO, the AOC engaged two independent experts in risk analysis to review and validate the process for Long Beach courthouse. Their findings,

which endorsed the approach taken as well as the results of each risk analysis workshop, were provided to the LAO.

#### *Leasing of Additional Space*

The report states that the VfM analysis assumption that additional space would be needed in the Long Beach courthouse in the future resulting in increased leased costs if not included in the project design was “not conclusively demonstrated.” The space plan for the new Long Beach courthouse includes 31 courtrooms and expansion space that could allow for 6 additional courtrooms to be provided for future growth. The expansion space is leased to non-court users until needed to accommodate additional courtrooms. Thus, the basic cost of providing new courtrooms that would be needed is not carried by the state, but by the private partner in the P3.

The VfM estimate of additional needed courtrooms (above and beyond those already proposed to the Legislature) that would be needed to serve the South District area in the future was developed in collaboration with staff of the Superior Court of Los Angeles County and used data from the AOC Office of Court Research and the Facilities Master Plan for the Los Angeles Superior Court. It was determined that by 2044, the need may be as high as nine additional courtrooms. This number was reduced to six in the Long Beach courthouse plan in consideration of past history that approval of new judgeships typically lags behind estimated need.

#### *Project Completion*

The report also questions as “not evident” the assumption in the VfM analysis that a traditional-build project would take 14 months longer than the Long Beach P3 project. No analysis is provided for that conclusion.

The AOC’s comparison and assessment of the design and construction schedules for the two delivery options indicates a distinct schedule advantage with the public-private partnership approach. This time advantage is due to an overlap of CEQA environmental clearance performed by the AOC concurrent with conceptual design activities during the Long Beach P3 proposal stage. Once the project agreement was executed, the private partner immediately began fast-track design and construction, with sequential bid packages to procure construction contracts in increments as needed for the site work and building assembly.

The private partner is strongly motivated to use fast-track design and construction since payments by the state will not begin until the superior court begins activities in the new building.

Simultaneous design, working drawings, bidding, procurement, and construction is a proven method used in private sector real estate development to avoid cost escalation and to expedite building completion; however, it is not allowed under the current procedures for building projects using the state capital outlay traditional approach (design, bid, build) and lease revenue bond financing. As our September report noted, within four days of one year from the Notice to

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Proceed, steel erection began on the site. Under traditional AOC delivery methods this major milestone would have taken at least two years to accomplish.

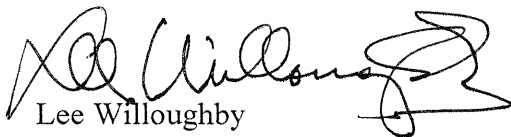
*Conclusion*

The VfM analysis for the Long Beach courthouse project, which was repeatedly reviewed by the other government branches and contained assumptions consistent with accepted practice, supports the conclusion that this project was a benefit to the state as a public-private partnership. The majority of development risks have been transferred to the private partner; the benchmarks—including the provision of space for future expansion at no risk to the AOC—have been achieved, and design and construction are on schedule and slightly under budget.

In summary, the Long Beach courthouse is an appropriate project for the public-private partnership procurement approach and the value for money analysis was performed reasonably and is consistent with industry practice.

We welcome the opportunity to work with you in your efforts to improve the P3 process for the state.

Sincerely,

A handwritten signature in black ink, appearing to read "Lee Willoughby". The signature is stylized and cursive, with a large initial "L" and "W".

Lee Willoughby  
Director, Judicial Branch Capital Program Office