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Washington State Legislature

January 12, 2006

Mike Murphy, Treasurer
Office of the State Treasurer
State of Washington
Legislative Bldg., Room 230
PO Box 40200
Olympia, WA 98504-0200

Dear Mike,

Thank you for the opportunity to provide advice to you as you prepared the Report on 63-20 Capital Project Financing. As members of the advisory committee we have learned a great deal and appreciate the conscientious and expert work of your staff.

While it appears that the current draft will meet the minimum requirements of the legislative directive, the study raised significant issues that could benefit from additional exploration and analysis. Without this additional work, this study is at risk of producing recommendations increasing the cost of financing and constructing major public facilities.

In general, we find this study's focus is too narrow because it compares only the financial transaction costs and interest rates of 63-20 financing with conventional bonds and other borrowing options. Financing costs are only one important dimension to consider. Other factors, including the total project and life-cycle costs, project schedules, and the more comprehensive view that is required when managing an entire project, can have significantly greater impact on total project costs.

We believe the Report on 63-20 Capital Project Financing could be substantially strengthened and made more useful to policy and decision makers if several specific issues are addressed further, including: (1) managing the transfer of risks; (2) the degree to which developers are insulated from the public construction oversight process and the costs and benefits of that isolation; (3) differences in the nature of design/construction processes when the debt holder/owner is not a public entity; and (4) the risk to public works. Substantial evidence about these aspects *is* readily available so doing this should not take an inordinate amount of time.

These issues are especially relevant now as we see increases in contractor claim payments, are faced with extended project schedules, and feel the pinch of cost inflation due to international competition for construction materials and skills. Reliance on traditional financing and public works contracting procedures alone may place the state at a disadvantage and cost our taxpayers more. Meanwhile, state agencies in need of new

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facilities may find themselves leasing space that could otherwise be acquired and owned by the state for its long-term needs. Unfortunately, these leases (amounting to 1.2 million square feet in the last 6 years) neither result in state ownership nor do they typically allow for tax exempt financing. This increases the finance and construction cost which state government ends up paying in higher lease rates than would otherwise be the case.

We suggest the above issues be addressed in a more comprehensive manner than was undertaken in the Report on 63-20 Capital Project Financing and in a manner which addresses the linkage between financing, construction, maintenance and ownership, not merely financing, so that the pros and cons can be delineated more completely. Given the current discussions of alternative contracting, shortfalls in maintenance and poor long-term capital facility planning, this could be a large service to future decision makers. This could be done as a combined effort that includes the Legislature and Executive so that experts from the development, financial, and construction/design communities can all participate as appropriate.

Thank you again and we hope that you can support our recommendation to study this important matter further.

Sincerely,

Karen Fraser

Senator Karen Fraser
Legislative District #22

Senator Mike Hewitt
Legislative District #16

Rep. Fred Jarrett
Legislative District #41

Rep. Timm Ormsby
Legislative District #3

Mike Roberts

Mike Roberts
Office of Financial Management

Thomas Gerlach
Turner Construction

KF:MH:FJ:TO:MR:TH:mt

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Benefits of Using 63-20 tax exempt financing

Timeliness: projects can be delivered much more quickly than the traditional design-bid-build procurement and delivery method

GMP: the developer identifies a guaranteed maximum price (GMP) at the end of design development stage

Risks: are appropriately shared:

- Interest rate risk — public sector jurisdiction
- Lease up risk – public sector jurisdiction
- Construction risk (schedule and price) – private sector developer

Approval Authority: jurisdiction maintains complete control and approval authority during the design and development process

Flexibility: trade-offs of budget, schedule & quality issues can be assessed in light of alternatives that the private sector developer presents to the local jurisdiction

Ultimate Ownership: jurisdiction is the *effective* owner of the project during the lease – becoming the actual fee simple owner upon expiration of the lease.

Development Expertise: reliance upon a private sector developer that is actively engaged in substantial and ongoing development projects

Development Coordination: developer acts as central design-build coordinator of all aspects of development, achieving the local jurisdiction's programmatic requirements

Negotiated Contracts: ongoing developer relationships with contractors, architects, engineers, and consultants are utilized and maximized on behalf of the project

Appropriate Incentives and Disincentives: identified in the development agreement and based upon the issues particular to the specific development requirements

Open Book: all aspects of the development project are entirely open book and subject to formal audit

Non-Profit Facilitator: non-profit facilitator / issuer of the 63-20 tax exempt debt provides substantial expertise and underwriting perspective in terms of accurately assessing project parameters

Property Management: can be accomplished using private sector contractors and approaches or blended with local jurisdictional management