CITY OF
LONG BEACH

Memorandum

Date: July 12, 2022

To: Thomas B. Modica, City Manager T.M.

From: Kevin Riper, Director of Financial Management KR

For: Mayor and Members of the City Council

Subject: **Update on Alternative Procurement Options**

On December 17, 2019, the City Council directed the City Manager to work with Financial Management and all applicable City of Long Beach (City) Departments to report back on the potential benefits, partnerships, and challenges of expanding Citywide procurement processes for development, construction, and building to include opportunities for alternative methods of collaboration and partnership. This memorandum is in response to that request.

Background

The City of Long Beach, like most public agencies in California, has generally awarded contracts for public works construction projects to the lowest responsive, responsible bidder. The traditional delivery method, often referred to as Design-Bid-Build (DBB), involves the City as the central project manager contracting the different stages of a project separately, often to different firms. In this approach, the public sector has a high level of control and responsibility in development projects and its role includes selecting the design, financing the project, and owning, operating, and maintaining the facility after construction. In a simplified example, the design team would develop the scope, program, and design of the project while the contractor, subcontractors, and material suppliers would build the project per the design specified in the contract. This approach generally provides the City with more control over the project, but can lead to a longer duration to complete complex projects, as City resources face competing demands for their limited time.

“Alternative” approaches for public works construction projects seek to involve the private sector in areas of project delivery where they have not traditionally been included, namely in financing, facility operations, and facility maintenance. Alternative approaches, also known as public-private partnerships (P3s), include, but are not limited to: Construction Manager/General Contractor, Design-Build (DB), Design-Build-Finance (DBF), Design-Build-Operate-Maintain (DBOM), and Design–Build–Finance–Operate–Maintain (DBFOM). The 1996 California Infrastructure Finance Act enables local governments to use alternative delivery models for specific revenue-generating infrastructure projects. The law stipulates that selection of partners be based on qualifications, facilities/infrastructure be operated at a fair and reasonable price, and the negotiation process be competitive. Beyond these stipulations, State law provides broad latitude for local governments to enter into P3s.

Of the four types of P3's the most commonly used is the DB. This type combines two otherwise separate operations into one contract. The public sector provides the financing and procures from a private partner (one firm or a consortium) what is traditionally a fixed-fee contract, that is, both the engineering and the construction services. In this setup, the private partner assumes the responsibilities and risks that come with completing the project for a fixed fee within a given timeline. The public sector maintains full ownership and financial liability for operation and maintenance. Recent examples of DB projects in Long Beach include but are not limited to the City-Wide Curb Ramp Project, the Airport Terminal Improvement Project, the Public Safety Parking Garage Project, the Compressed Natural Gas Fuel Station Project and most recently the Belmont Pool Project.

The most complex form of a P3 is the DBFOM. With this type of build the financing, design, construction, operation and/or maintenance of a given project are bundled together under one contract, which is awarded to a private or nonprofit partner. Future revenue streams are used to leverage the initial full or partial financing of the project. Although it is not always the case, it is quite common that under such agreements the entire responsibility for raising funds falls on the private partner. The most recent example under this model is the Long Beach Civic Center by the City and the Long Beach Courthouse by the State.

Benefits and Challenges

The City's Purchasing Agent met with members of several City Departments, including Airport, City Attorney, Financial Management, Energy Resources, Parks, Recreation and Marine, and Public Works, to discuss the benefits and challenges of alternative approaches.

The following benefits were identified:

- Access to private sector expertise, creativity, and technical developments. Some projects, such as those at the Airport, can benefit even more from access to additional experts.

- Access to private sector production efficiencies and economies of scale.

- Increase in governmental capacity to respond to public needs. Allows for government entities to take on more projects, which can result in more public infrastructure like parks, highways, and facilities.

- Allows for risks to be transferred from the government to the private sector. The private sector takes on the risk of project schedules, budget overruns, and maintenance, which in turn incentivizes the private sector to deliver projects on-time and under budget and provide for regular maintenance of projects.

- More flexibility in structuring of short-term finances. Private sector funding mechanisms can help with project cash flow during construction while the public agency arranges long-term debt financing with final maturity matched to the useful life of the project being built.

The following challenges of alternative approaches were identified:

- Difficulty in drafting the contract terms. The complexity of the project and the large number of unknown factors yet to be determined can lead to poor selection of partners and/or contract terms that are insufficient to fully protect the interests of the public and the City. It is unlikely the City will be able to anticipate every eventual need over a long-term contract. The impact of decisions today may not be felt for decades, and that impact is potentially financially harmful.

- Uncertain financial terms in the long run. Because they are long-term arrangements, usually over multiple decades, sometimes discount rates or other assumptions made when analyzing and comparing future costs can prove inaccurate as events unfold due to unpredictable and uncertain future conditions.

- The City has less input over multiple aspects of projects, including design and construction management. This can lead to elements of the project being at a lower quality because it is potentially cheaper for the private sector partner to do simpler designs and use lower quality products in the final construction.

- Long-term instability of partnerships due to the volatility of the private sector. It is not unusual for private firms to experience a change in ownership structure, be taken over by other companies, or go out of business altogether. At best, this results in having to re-establish relationships and partnerships; at worst, the public sector takes the loss.

- Loss of potential public revenue. The assets could have generated long-term revenue for the public; instead, the revenue stream is going to private interests.

- Less ability to incorporate racial and other equity concerns into project planning. The private sector's focus on the bottom line can conflict with adequately addressing equity concerns in the project delivery, and the structure of the contractual relationship can make it difficult for the City to ensure compliance.

- Access for all members of the public may not be possible. In many instances, the private sector generates revenue on the project from admission charges or other mechanisms that could preclude some members of the community from utilizing or enjoying the completed project, like private toll roads or facility concessions.

- The City's cost of capital is almost always less than that of any private firm, because the City is able to issue tax-exempt (or even taxable) bonds at noticeably lower interest rates than private firms. Thus, debt service costs for a P3 project financed long-term with private funds are almost always going to be higher than if the City itself issued the debt.

Summary

Alternative procurement approaches for construction projects are at times beneficial to the City, but caution should be exercised to ensure appropriate contracts are put into place to protect the City's current and future interests, some of which may not be known at the time of project initiation. While the promise of P3s can be attractive, there are ample possibilities for the City to incur great risk and cost. It is vital that the City take sufficient time and care to evaluate the risks, consult expert business and legal advisors, and negotiate the terms to ensure the contract reflects the City's interests, values, and goals. Otherwise, the long-term nature of these agreements means the City could be dealing with unforeseen consequences for decades. Therefore, it is essential that the City approach each unique project with great caution and thoroughly evaluate the costs and benefits of each project before determining the best approach.

If you have any questions, please contact Tara Mortensen, Business Services Bureau Manager, at (562) 570-6340.

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