Future of the Oahu Community Correctional Center

Volume 7 – Financing Development of a New Community Correctional Center

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Hawaii Department of Public Safety

The Hawaii Department of Public Safety (PSD) operates the Oahu Community Correctional Center (OCCC) which acts as the local detention center for the First Circuit Court. Located within an approximately 16-acre property at 2109 Kamehameha Highway in Honolulu, OCCC is currently the largest county jail facility in the Hawaii system. From its beginning in 1975 as a part of the county-based community corrections system concept with 456 beds, the facility has been expanded to its current design capacity of 628 beds and an operational capacity of 954 beds and consistently operates above these capacities.

OCCC provides the customary county jail function of managing both pre-trial detainees and locally-sentenced misdemeanant offenders and others with a sentence of one year or less as well as providing a pre-release preparation/transition function for prison system inmates when they reach less than a year until their scheduled release. It's important to note that the inmates housed at OCCC are under the jurisdiction of the Judiciary (courts) and not PSD. Detainees in jail can only be released, placed in outside programs or assigned to other alternatives to incarceration by the Judiciary (courts).

Oahu Community Correctional Center

Alternative Project Financing and Delivery Models

With increasingly aged and obsolete correctional facilities, PSD has proposed improving its corrections infrastructure through modernization of its existing facilities and construction of new institutions to replace others. Among its priority projects is the replacement of OCCC which, when constructed, will take advantage of the newest cost-savings technologies and improve correctional services and safety for both inmates, staff and the public.

Developing a new OCCC is a complex and expensive undertaking. Therefore, it is appropriate that options available for financing construction of a new OCCC be evaluated early in the planning process, recognizing that the investments needed now and in the future could impact future budgeting cycles. The financing options described herein are intended to initiate a discussion of financing and delivery methods and do not constitute a recommendation of any specific approach.

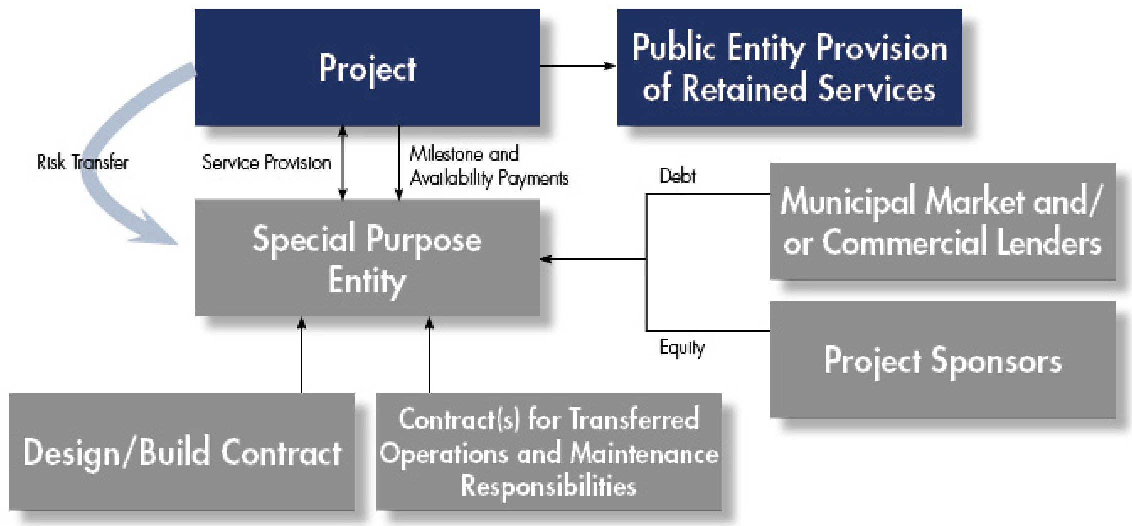
Oahu Community Correctional Center

Financing Options

The decision whether to use public or private financing for a public works project such as a new OCCC is driven by various legal, financial, and other factors including the nature and scale of the project and the fiscal health of the public entity sponsoring its construction and operation. Public financing of a large capital project could be constrained by legal limits on the degree to which local or state governments can incur debt and/or if development of the project will affect its ability to fund additional public facilities and infrastructure improvements, on-going operations, and other obligations.

Unfortunately, correctional facilities are viewed by some as low priorities for public financing and convincing an electorate to approve the sale of bonds to fund such projects can be far from guaranteed in light of pressing needs for financing new schools, health care facilities, transportation systems, and other public facilities.

With the advent of public private partnerships (PPPs or P3), along with a relatively slow-growth national economy, local and state governments across the U.S. have become increasingly amenable to leveraging private sector capital and expertise in designing, building, and financing new public facilities and infrastructure. Although private sector partnering has been most frequently used to finance transportation projects, PPPs for other types of public infrastructure has become possible using innovative partnership arrangements. Under PPPs, the public agency typically repays the private investor directly through leasing fees, or "availability payments" (with payment made on the basis of continued availability of the services).



Types of PPPs: Availability of Payment

Government policies and preferences for providing public services can also influence decisions as to which financing plan option to employ. This means that the community objectives and priorities, the economic development plans and long-term strategies can serve as tools in the decision-making process. These policies include:

- Long-term objectives
- Taxation framework
- Legislative framework
- Financial resources and status

Other economic development, land use, and employment objectives are also relevant because they could determine when private financing should be considered. Usually governments establish the conditions under which private or public financing would be used.

Conventional Public Financing Options

Jails, prisons, courthouses and similar public safety facilities, like other public infrastructure, have historically been funded by either "pay as you go" or by the sale of bonds. "Pay as you go" involves the appropriation of public monies necessary to complete the proposed project within a single fiscal year. If project construction spans more than a year, then additional funds must be appropriated for each year of construction activity. Under the "pay as you go" approach, a project is explicitly funded as a line item in a government's annual budget. This funding method is commonly used for small capital projects that can be accommodated within the jurisdiction's typical annual budget. This approach is not effective when a large capital project investment could lead to cutbacks in other projects or require additional means for raising tax revenues.

"Pay as you go" is the least costly financing plan option over the life cycle of a project because it would involve incurring no debt and the associated accrued interest payment. An additional benefit is that future revenues are not burdened and actual expenditures can be handled more efficiently when the revenues are appropriated from the current budget. For larger capital projects, including those which require large investments and multiple years to construct, governments typically finance construction costs by issuing bonds. Schools, parks and recreational facilities, cultural institutions, and health care facilities are among the most common public improvement projects funded through the issuance of bonds.

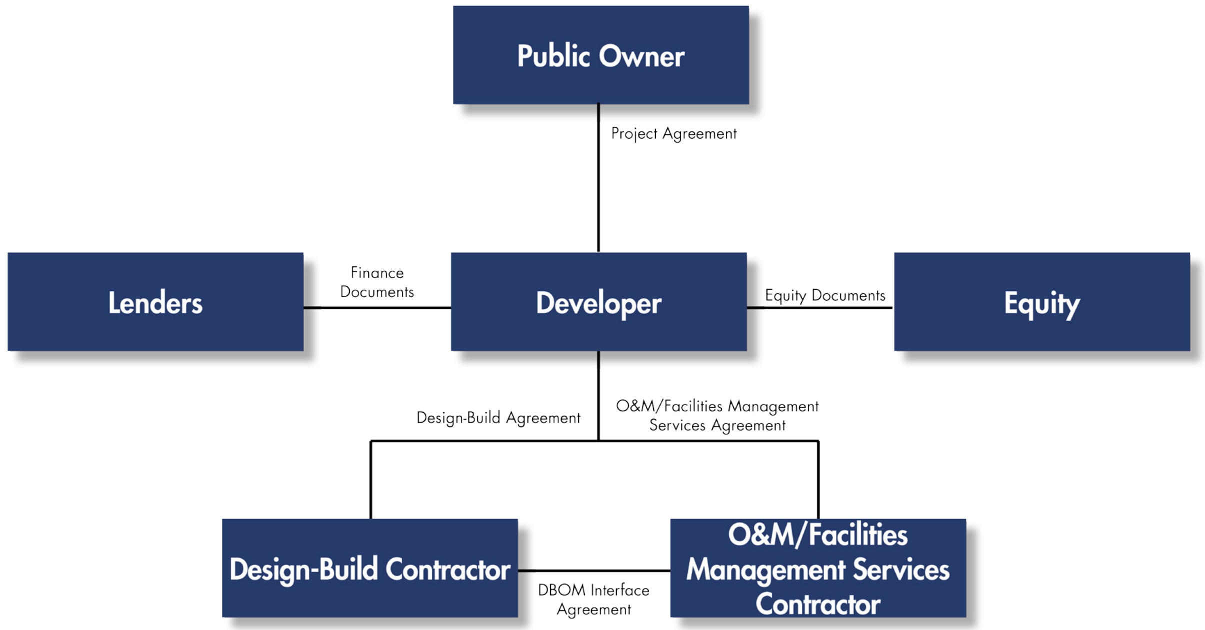
Bonds

A bond is a security instrument which acknowledges that the issuer has borrowed money and must repay it to the bondholder at a specified rate of interest at periodic intervals. A bondholder also receives the amount lent (the principal) when the bond reaches its maturity. Bonds are known as debt securities and are different from loans because they can be publicly traded and have values that can fluctuate. Debt securities with a maturity of 13 months or less are known as notes; however, bond maturity can last up to 30 years.

There are different types of bonds that can be issued by a government and each type has ramifications for the level of interest rates paid by the issuer, a jurisdiction's credit rating, and impact on debt ceilings.

General Obligation Bonds

Until the 1980s, General Obligation Bonds (GOs) were the most frequently used form of public financing for correctional facility construction. However, the use of obligation bonds has declined as states and counties faced higher budget deficits and fiscal challenges, including limits on accrued debt as well as competing priorities for the use of bond financing. GOs are still a relatively low cost method for obtaining capital for large public infrastructure projects. This is because GOs are fully backed by a pledge of the issuer to collect sufficient revenue (e.g., tax revenue) to repay the principal and interest. Because they are backed by the "full faith and credit" of the local government, financial markets consider GOs among the most secure investments. Accordingly, the low risk of GOs translates into reduced interest rates paid to investors and a lower overall project cost. By the end of the 1990s, approximately one-third of all publicly-issued debt was GO debt. These bonds were used for a broad variety of public works projects including roads, airports, parks and correctional facilities.

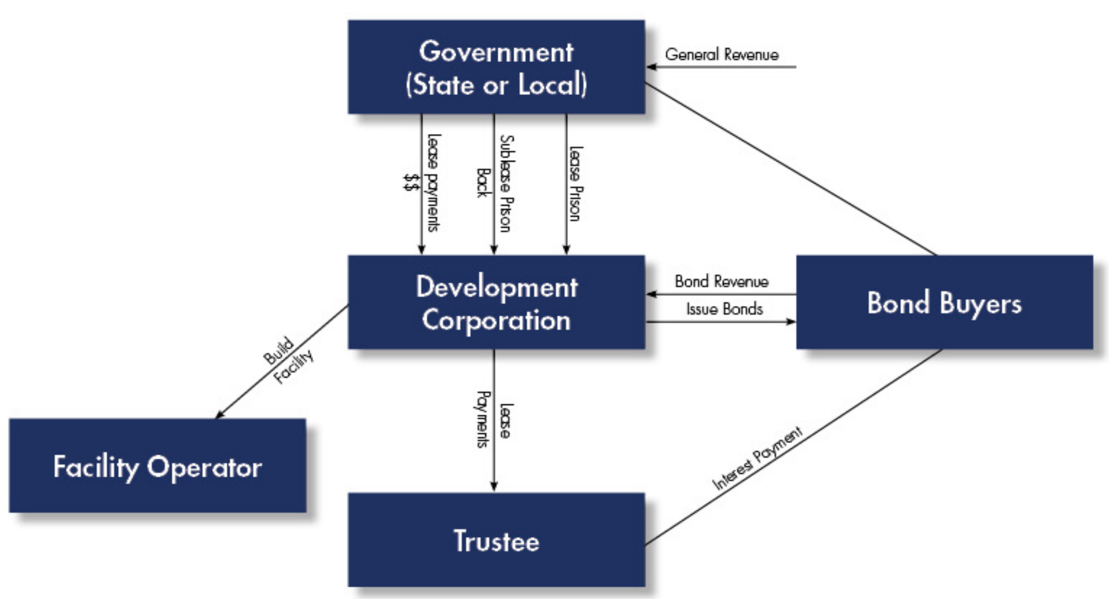


P3 Structure

Revenue Bonds

Revenue bonds are commonly characterized as "limited obligations" or "special obligations" and as such the debt does not count towards a state's debt limit. Revenue bonds typically finance public projects such as toll roads, bridges, airports, water and sewage treatment facilities, hospitals and subsidized housing. By 1997, revenue bonds accounted for at least 50 percent of all publicly-issued debt. To issue a revenue bond, the government creates a separate non-profit organization to issue lease revenue bonds. This non-profit organization, usually a state or county development authority, uses the bond revenue to build the facility and then leases it to the government at a rate that will allow full repayment to the investors (principle and interest) by the end of the lease period. The title of the facility reverts to the government agency when the bond or the lease has been paid in full.

County and state governments tend to use revenue bonds when the debt ceiling has been reached or when it is very difficult to obtain voter approval for obligation bonds. All bonds of the State other than special purpose revenue bonds must be authorized by a majority vote of the members to which each house of the Legislature is entitled. Special purpose revenue bonds of the State must be authorized by two-thirds vote of the members to which each house of the Legislature is entitled.



Revenue Bond Financing Process

Sales Tax Revenues

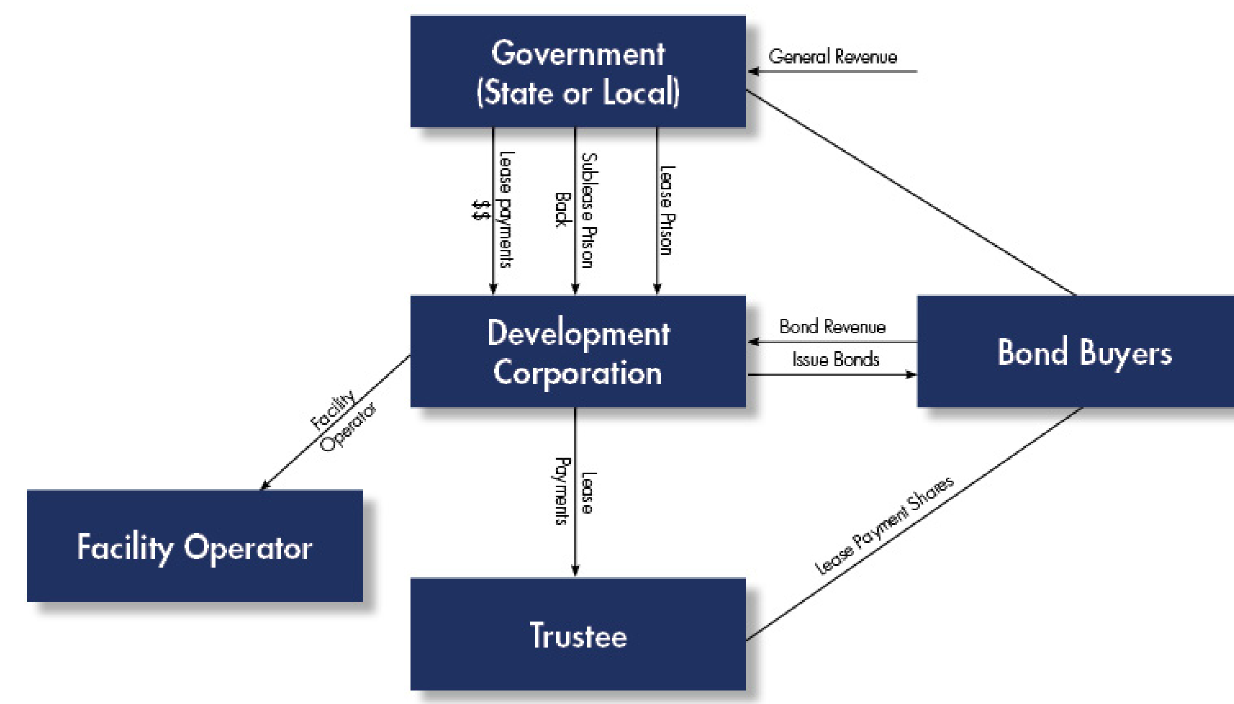
One mechanism for generating a regular revenue stream would be the imposition of a special sales tax that could be directed exclusively for OCCC construction. Under this approach an additional levy would be added to the current tax rate that is collected at the point of sales by retail establishments operating within the state. Hawaii does not impose a sales tax, but it does have a gross receipts tax called the General Excise Tax (GET). The GET is 4% throughout most of Hawaii, and 4.5% on Oahu, but the state allows a business to charge their customers a maximum of 4.712% to help recoup some of their total GET.

Sale of State Assets

Another approach for potentially generating significant funds, although on a one-time basis, would be to designate selected state property and assets as surplus and put them up for sale. Before such property or an asset can be sold, however, the state must declare it to be surplus. In addition, prior to taking any such action, it would be prudent to conduct a comprehensive review of its current and future needs for the property and the financial impact of selling assets to finance a large capital project of this nature as once state assets are sold to private investors those assets are forever lost for public purposes.

Certificates of Participation

In recent years, governments have begun using a specialized type of revenue bonds to finance capital projects, referred to as Certificates of Participation (CoPs). CoPs are lease financing agreements in the form of securities that can be issued and marketed to investors in a manner similar to tax-exempt debt. By entering into a tax-exempt lease financing agreement, a public agency is using its authority to acquire or dispose of property, rather than its authority to incur debt. CoPs are sold through an underwriter and the proceeds of the sale of the CoPs are used to pay the cost of acquiring or constructing improvements.



COP Financing Process

Public Private Partnerships

Public Private Partnerships (PPPs) are collaborations between governments and private entities to provide public infrastructures, facilities, or services for long-term periods through the sharing of risks, responsibilities and rewards. These partnerships are formed to optimize the advantages that the private sector can offer in building and/or operating public facilities and infrastructure. As noted earlier, this document focuses on the potential to use private entities for financing and constructing a new OCCC facility, with jail operation remaining the sole responsibility of PSD.

Type of Public Private Partnerships	Description
Private-Finance-Build-Transfer	Private partner finances and provides for design and construction of the facility and transfers it to the public entity
Design-Build-Finance	Private partner provides the financing, design and construction
Performance Based Infrastructure	Responsibilities for designing, building, financing, and maintaining are bundled together and transferred to private sector partners. Lease payments to private entity contingent on performance.
Developer Finance	Private partner finances the construction of the facility in exchange for the right to build residential housing, commercial or industrial developments
Lease/Purchase	Private partner finances and builds the facility which it then leases to a public entity

Types of PPPs

The roles of the private sector can vary depending on a project, but it is ultimately the government's responsibility to ensure the integrity of the facility. Such arrangements and partnerships clearly delineate the physical ownership of the facility, what role a private firm is going to fill in the development and operation of the facility as well as the contractual obligations of the private corrections firm. In contracting with private firms, governments must balance their obligations to protect the public and provide for the social welfare with the private firms' need to run its operations in an efficient and effective manner. If a government imposes too few regulations or oversight, the firm may have an incentive to act contrary to the government's interest; if it imposes too many regulations, it may be too costly for the firm to operate.

If the State of Hawaii was to consider a PPP plan option, a thorough analysis would be necessary to compare the life cycle costs of a PPP plan option to a conventional public financed and owned option. The analysis would need to take into account how project construction and operation risks would be apportioned under the different scenarios. The lowest cost alternative might not be the optimal choice if the risks are higher compared to other alternatives. Risk allocations will also have an impact on how any PPP is configured. The higher the risk allocated to the private sector partner, the higher the return on investment that will be expected by the partner to make the investment attractive.

Financing Plan Option	Advantages	Disadvantages
General Obligation Bonds	• Low interest rate on the bond; public agency maintains ownership throughout the life of the facility • Bond and interest payments backed by property tax revenues instead of appropriations or other funding sources • Public agency maintains full control of jail operations • Public agency may implement the project using any delivery method	• Voter or legislature approval may be required to issue bonds for jail construction. • Interest rate and available bondholders subject to conditions in the financial markets • Public agency's debt ceiling may have been reached • Advice should be sought from public sector market-makers to assess the financial viability of new bond issuance
Revenue Bonds	• Bondholder assumes financial risk of the investment • Voter approval of bond issuance not required • Public agency maintains full control of jail operations • Public agency may implement the project using any delivery method	• Higher risk due to the lack of guaranteed availability of funding sources throughout the life of the project • Government regulations may apply as to the limits of specific types of funding sources
Special Sales Taxes	• Project can be funded without incurring additional debt while retaining full ownership	• In place of sales tax, Hawaii has a gross receipts tax levied on businesses which is, in many ways, stricter than a standard sales tax
Sale of State Land and Other Assets	• If sold parcels and assets are sufficiently large, project could be funded in part though one time sale while incurring a lessor amount of debt	• Sale to private sector removes valuable asset(s) from the state's resource inventory
Private Public Partnerships	• Privatization of the construction will not impact the government's capital budget • Public agency will not have to acquire capital from the financial markets nor work with public sector market-makers • Public agency does not bear the financing or construction risk of the new facility	• Public agency may not have control of project delivery method • Operational responsibility is retained by the public agency

Comparison of Types of Financing Plans

Governor Dukemasioan Corthouse

Examples of Alternative Project Financing and Delivery Models

Performance-Based Infrastructure: Long Beach Courthouse, California

The Long Beach, California Courthouse handles a variety of civil litigation and all criminal matters for the cities of Long Beach, Signal Hill, San Pedro, Wilmington, Harbor City, and a portion of the City of Los Angeles. Built in 1959, the courthouse averages 385 felony and 3,327 misdemeanor filings per month; 225 in-custody defendants move through its corridors each day and over 100,000 people enter the building per month. The courthouse suffered from fundamental flaws, overcrowding, and a failure to meet accessibility requirements, making it incapable of meeting the growing demand for court services in the Long Beach area.

In 2007, the California Administrative Office of the Courts (AOC) evaluated the feasibility of replacing the courthouse in addition to renovating and expanding the existing facility. Due to age, physical condition, and functional issues, funds were appropriated for a new courthouse with construction to occur from January 2011 to September 2013. The finished 545,000 square foot, five-story building, houses 31 courtrooms as well as administrative offices, Los Angeles County lease space, and retail space. The total contract value was $364 million of which approximately $339 million was for construction.

Delivered through a PPP agreement with the Judicial Council of California, the Governor Deukmejian Courthouse was the first social infrastructure project in the U.S. procured under the principles of Performance-Based Infrastructure (PBI) contracting. Under a turnkey PPP, the cost and risk of the courthouse, including development, design, construction, operations, and maintenance were transferred from the public sector to the private-sector team. The developer paid $49 million in equity at financial close with the balance of funding arranged in loans from several large domestic and international banks with a seven-year floating interest rate to cover the three-year construction period.

The Judicial Council determined that PBI delivery was the best approach to address the need for a new courthouse and the best value financing method for the residents of California. Compared to the traditional state project delivery, PBI enables a project to proceed without state financing and can produce a more innovative and better-performing facility with significantly speedier delivery by leveraging the private development to allow the state to transfer certain risks to the private sector. It also provides for the on-going maintenance and performance of the facility. Under the PBI agreement, AOC owns the building and is leasing a six-acre parcel for 50 years. The Superior Court of Los Angeles County occupies the building with the AOC paying an annual availability payment for 35 years. Under the terms of the agreement, the AOC can deduct a specific amount from the availability payment if components of the building do not function properly.

The service fee of $53 million encompasses a fixed capital charge component and an operating charge component (increased by inflation). There is also a revenue stream for the County from the parking structure. If the project agreement expires as scheduled in 35 years, and everyone has performed satisfactorily, the lease will terminate and control of the property will revert to the State. Execution of the project required a commitment to scheduling while maintaining the price-certain contract with stakeholder input. Under this delivery method, the project met the goals of the client and the expertise of the private-sector team was integrated into the development and design-build process. The courthouse was also completed 11 days ahead of schedule.

Availability Payment P3 Project: University of California, Merced 2020

The Merced 2020 Project is the first higher education Availability Payment P3 project to be awarded in the U.S. The goal of the University of California (UC) Merced 2020 Project is to expand the physical capacity of the campus to support projected enrollment growth from 6,700 current students to 10,000 students within 5 to 7 years. In July 2016, the UC Regents approved a budget of $1.3 billion for the Merced 2020 Project; of that total, $600 million will come from UC external financing with the developer contributing $590 million and campus funds accounting for $148 million. The project agreement is for a 39-year term, commencing on the date of contract execution (four-year construction period and 35-year operating period).

The funding is a PPP known as an "availability-payment concession," in which a single private development team designs, builds, operates and maintains major building systems and partially finances the entire project under a single contract known as the project agreement. During construction, UC will make predetermined progress payments to the developer. Once the buildings become available for use, UC will make performance-based "availability payments" that cover remaining capital costs, as well as the operations and maintenance of major building systems. This hybrid model has the same time and cost advantages of a "design-build" approach and adds a preventative capital-maintenance program and capital-renewal program. It does not transfer UC's property rights, nor does it assign revenue streams and is not a lease.

UC Merced

Current Marion County Justice Center

Availability Payment P3 Project: Marion County Justice Center

The need for modern justice facilities in Marion County, Oregon were studied for 20 years. Presently, the Marion City County Building was designed for 16 courtrooms and now has 34 while the county jail is spread amongst four antiquated facilities that are at capacity. Multiple locations and aging facilities create inefficiencies in addition to safety and security concerns since judges, attorneys, the public and defendants walk the same hallways.

The proposed Marion County Justice Center was intended to solve those deficiencies to include a new criminal courthouse for the Marion County Superior Court; a new Marion County detention center; a new Sheriff's Department; a community corrections facility; an Intake – Mental Health unit; utility building; and warehouse (total: 1.272 million square feet); staff parking, public parking, judge/juror parking; space for a new law office building with parking; and space for future expansion for detention, courts, civil, and community corrections.

The key financial aspects of the Availability Payment P3 project is for an annual service fee payment by the City-County of $46.8 million (in 2019 dollars) which is less than the City's affordability limit. The total construction cost of the campus and the facilities is $408 million while the present value of the service fee payments the City would make over the 35-year term of the agreement is $717.7 million which would cover construction costs and maintenance and operation over the term of the agreement.

Under the agreement, the City would own the site and facility while the project company would have a non-exclusive license to access the facility to perform the contract services. Under this financing plan, the project company is solely responsible for obtaining and repaying all financing necessary for the facility at its own cost and risk. Subject to certain interest rate adjustments, the project company bears the risk of any changes in the interest rate, and payment provisions of other terms and conditions of its financing.

Summary

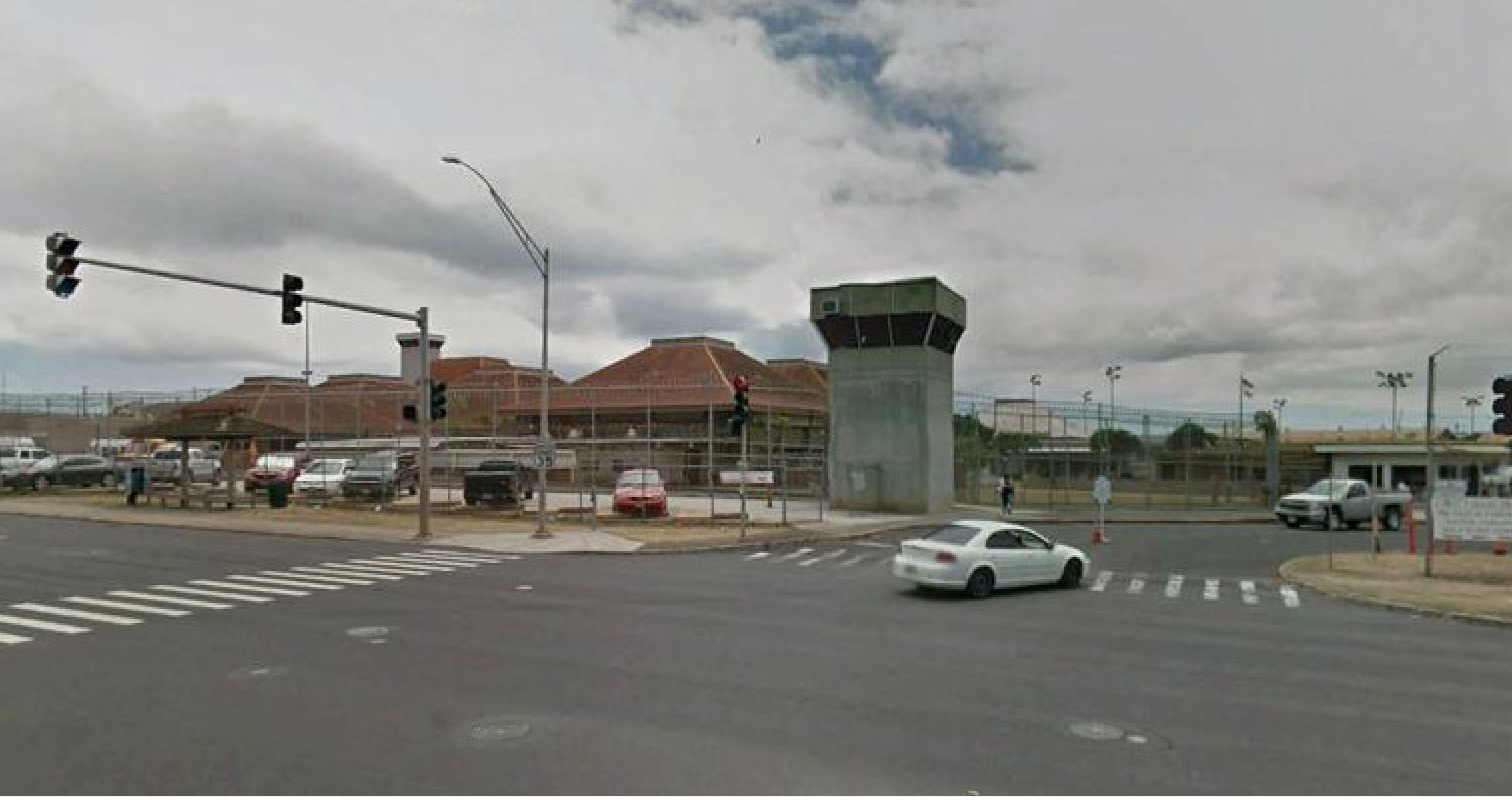
This document provides a brief description of some of the financing and delivery model options available for the proposed OCCC. It is not intended to promote any specific financing or delivery option but rather to provide an overview of the innovative methods being considered by state and local entities. OCCC financing and delivery approaches will be studied in the year ahead; at this time no findings or recommendations have been made.

Private sector participation in construction, maintenance, and operation of public facilities and infrastructure has increased significantly over the past decade, but its appropriateness for use depends upon the specific project under consideration. Use of a PPP financing approach could be appropriate if one of more of the following criteria is met:

- Budget and/or debt limitations constrain public sector financing;
- Project is complex and public sector seeks to spread some risk to private sector;
- Quality of the project or the service (operator) would benefit;
- Private partner can be incentivized to complete the project more quickly;
- Legal framework is in place that is conducive to private sector involvement (i.e., there are no prohibitions to private involvement);
- Completed project is able to generate lease payments and/or user fees to provide investor with sufficient return on investment;
- Decision-makers are amenable to private sector involvement; and
- Taxation framework confers advantages for private sector partners.

A project would have to meet multiple criteria for the conditions to be conducive for a successful PPP. As seen from the criteria, the factors favoring or disfavoring private participation are legal, economic, financial, and political.

If the State of Hawaii was to consider a PPP approach, a thorough analysis would be necessary to compare the life cycle costs of a PPP plan option to a conventional public financed option. The analysis would need to take into account how project construction and operation risks would be apportioned under the different scenarios. The lowest cost alternative might not be the optimal choice if the risks are higher compared to other alternatives.



Upcoming Activities

PSD is moving ahead with the OCCC planning process with these activities planned in the months ahead.

February 2017	Identify highly rated sites from among universe of prospective sites. Subject highly rated sites to detailed study via the environmental impact statement process. Continue community outreach process with informational meetings and other forums to engage public in discussions about finalist sites, planning process, path forward, etc.
March 2017	Continue environmental impact statement process. Continue public outreach and engagement process.
April 2017	Continue environmental impact statement process. Continue public outreach and engagement process.

Interested in Learning More?

For additional information about PSD, visit **http://dps.hawaii.gov/occc-future-plans** or contact:

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