

PUBLIC/PRIVATE PARTNERSHIPS OFFER INNOVATIVE OPPORTUNITIES FOR SCHOOL FACILITIES

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MPPI

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EXECUTIVE SUMMARY

Over the past decade, concern over the adequacy of existing public school facilities has become an important component of the education debate in communities throughout the nation. In both cities and suburbs, students, parents, teachers, and many public officials argue that school buildings are overcrowded, obsolete, and/or unsafe. As a result, how much money is available for school construction, modernization and renovation has become a significant issue in state and local politics. In response to such pressures in Maryland, Governor Ehrlich announced in early 2005 that his budget for next year would include \$157 million for school construction, the largest amount proposed in three years.

Despite these common concerns about the under-funding of school facilities, federal data on national construction trends reveal that spending on public schools has been soaring over the past 10 years in comparison to spending on other types of buildings, including residential housing. According to federal data collected by the U.S. Census, spending on school and university facilities has increased 213 percent over the past 10 years, and is growing almost twice as fast as spending on new residential construction, which itself is having one of the biggest production booms in recent memory. But despite this surge in spending, shortages of classroom space still exist in some communities.

- It is estimated that 17,000 students in Montgomery County attend classes in 719 portable classrooms, and that the school system is seeking \$126 million for new schools in 2006 alone.
- The number of Prince George's County students housed in its 419 portable classrooms could fill 15 new elementary schools, and high school enrollment is expected to rise by 4,000 in 2008.
- Overcrowding in Howard County has forced some students to use the cafeterias and libraries as classrooms, and one school designed for 440 students now serves 700.
- Declining enrollment has left Baltimore City with too few students in too many schools, and insufficient funds to keep them all in good repair. Twenty-one schools, some dating from the 1920s, are less than 50 percent filled.

Adding to the funding problem has been the recent escalation in the cost of materials used in school construction, leading to a situation where more money buys fewer schools than communities anticipated when the funds were initially budgeted. In Maryland for example, school construction costs are running 20 percent above last year's projections, and the state's Interagency on School Construction is recommending that construction cost guidelines be raised from \$156 per square foot to \$176. In Howard County, an elementary school design that cost \$92 per square foot to build in 1999 now costs \$157 per square foot. And across the Potomac River in Arlington, Virginia, some contractor bids for school renovation projects are coming in almost 50 percent higher than projected.

Another factor contributing to the acceleration in school facility spending may be that the country has entered a high-intensity replacement cycle where many of the schools constructed between

the 1950s and 1970s to accommodate the baby boom enrollment are now reaching obsolescence and are being replaced to accommodate the more modern needs of the “echo boom’s” echo. At the same time, new schools being built to accommodate enrollment growth—particularly in the fast growing ex-urbs of major metropolitan areas—may be costing more because citizens are expecting, or demanding, better quality and more elaborate facilities than were typical of the past when public construction was more utilitarian than it is today

Despite what appears to be broad community support, the school construction boom has not been free of problems; chief among them is finding the money to pay for the new projects. The 200 plus percent increase over 10 years in school construction outlays has led to a surge in government spending, increased debt, and higher taxes to pay for it. And with popular public wants confronting limited resources, many communities are looking for alternative sources of funding, and this, in turn has led to a number of innovative solutions emerging in communities throughout the United States, Canada, and the United Kingdom. Many of those innovations involve partnerships with private sector developers, builders, other service providers, community not-for-profits, and other branches of state and local government. While some of these innovations are still in the experimental stage, they offer a rich menu of attractive options that other communities can emulate or modify to better fit their own circumstances. In another instance, recently enacted federal school construction programs, if changed slightly through legislation, could offer a big boost to the process of experimentation and innovation.

Although Maryland has not been on the cutting edge of innovative solutions for funding school construction, it is not far behind and is making significant efforts to close the gap. In 2004 the Maryland state legislature enacted a bill—modeled on Virginia’s 2002 path-breaking legislation—to allow the formation of public/private partnerships for public school construction. Another law passed in 1994 permits the formation of Community Development Authorities (CDAs)—essentially special taxing districts to fund public infrastructure such as wastewater treatment, roads, and schools. For counties concerned about the potential infrastructure costs of new residential developments, CDAs could more effectively and equitably fund those expenses than would impact fees and proffers. As the detailed report that follows notes, already some Maryland builders are offering to fund the construction or expansion of public schools in exchange for approval of their new residential development projects.

Over the past decade, concern over the adequacy of existing public school facilities has become an important component of the national education debate as parents, teachers, and other public education advocates contend that many school buildings are overcrowded, obsolete, and/or unsafe. As a consequence, the financial resources available for school construction, modernization, and renovation have become a significant issue in state and local politics, and have also become the subject of court rulings requiring states, cities, and counties to spend more on school buildings and other physical facilities. Indeed, such was the concern that in 1997 the Clinton administration proposed a massive increase in federal financial aid for public school construction, making it a federal responsibility for the first time in history.¹ Despite substantial bipartisan support for the legislation, Congress did not enact the proposal.

Notwithstanding these common concerns about the under-funding of school facilities, federal data on national construction trends reveal that spending on public schools has been soaring over the past 10 years in comparison to spending on other types of structures. Table 1 provides summary data on these trends by major construction category.

TABLE I
Value of New Construction Put in Place
Percentage Change: 1994 – 2004 for Select Type

Type Of Construction	Percentage Change
Primary/Secondary Schools	213.5%
Higher Education	173.3
Residential, Private	110.5
Total State and Local Construction	103.0
Total Private/Public Construction	85.0
Non-Residential, Private	38.6
Total Federal Construction	20.0
Prisons and Jails	8.5

Source: U.S. Bureau of the Census, "Annual Value of State and Local Construction Put In Place."

As recent trends indicate, spending on school and university facilities has increased at a rapid rate over the past 10 years, and is growing almost twice as fast as residential housing, which itself is having one of the biggest production booms in recent memory. It should be noted that another organization that collects school construction data independent of the federal government comes to a similar conclusion on these trends, noting that:

The amount of construction put in place in 2003 by the nation's education institutions reached an all-time high, even as spending in other areas was curtailed significantly... School districts and colleges spent \$48.1 billion on construction in 2003. The amount represents an almost 20 percent increase in spending compared with 2002. And there is little sign that the robust spending on construction will slow

1. See Ronald D. Utt, "How Public-Private Partnerships Can Facilitate Public School Construction," Heritage Foundation *Backgrounder* No. 1257, February 25, 1999.

anytime soon, as almost \$150 billion is projected to be spent over the next three years.²

What these numbers do not tell us is how many new schools, additional square feet of class room space, or new student stations this increased spending is providing to communities. One obstacle to making such judgments is that the U.S. Bureau of the Census no longer provides inflation-adjusted estimates, so the rates of change presented in Table 1 include 10 years-worth of price increases as well, suggesting that the number of new and renovated schools increased by an amount much less than the 213 percent the unadjusted numbers suggest. Although there are no data available of school cost trends, some anecdotal evidence suggests they may have been substantial in recent years. In Maryland for example, school construction costs are running 20 percent above last year's projections, and the state's Interagency on School Construction is recommending that construction cost guidelines be raised from \$156 per square foot to \$176.³

School construction spending is also outpacing growth in enrollment by a substantial margin. Between 1994 and 2002, public school enrollment (N-12) increased by 6.5 percent while public school construction spending increased by 204 percent. This suggests that—at least on a nationwide basis—school crowding and soaring enrollments are probably not much of a factor in explaining the surge in new construction.

Another factor at work may be that the country has entered a high-intensity replacement cycle where many of the schools constructed between the 1950s and 1970s to accommodate the baby boom enrollment are now reaching obsolescence and are being replaced to accommodate the more modern needs of the “echo boom's” echo. At the same time, new schools being built to accommodate enrollment growth—particularly in the fast growing ex-urbs of major metropolitan areas—may be costing more because citizens are expecting, or demanding, better quality and more elaborate facilities than were typical of the past when public construction was more utilitarian than today.

Whatever the cause of the increase since the early 1990s, there is every reason to believe that the surge in construction spending closely reflects the will of the citizens to spend more on school buildings. In most communities, new schools (and major renovations) require approval of an elected school board and the same from a city or county council, followed by a bond referendum that must be approved by the voters. To survive this gantlet of democratic process, such spending must have substantial community support. Interestingly, the surge in school facility spending does not necessarily appear to reflect an across the board endorsement of more spending for all aspects of public education. As one national education organization notes: “Even as school districts and colleges continue to cut operating budgets, spending on construction booms.”⁴

Despite what appears to be broad community support, the school construction boom has not been free of problems; chief among them is the money. A 200 plus percent increase over 10 years in a major component of a local government's budget has led to a surge in public spending,

2. “Growth Spurt: 30th Annual Official Education Construction Report,” American School and University, May 2004, accessed at www.asumag.com (June 29, 2005).
3. Sean R. Sedam, “Schools face higher costs for construction,” *Gazette.Net*, April 13, 2005, accessed at www.gazette.net/200515/montgomerycty/education/269396-1.html (June 29, 2005).
4. “Growth Spurt,” American School, May 2004.

increased debt, and higher taxes to pay for it. And with popular public wants confronting limited resources, many communities are looking for alternative sources of funding, and this, in turn has led to a number of innovative solutions emerging in communities throughout the United States, Canada, and the United Kingdom, and many of those innovations involve partnerships with private sector developers, builders, other service providers, community not-for-profits, and other branches of state and local government. While many of these are still in the experimental stage, they offer a rich menu of attractive options that other communities can emulate, or modify to better fit their own circumstances. In some cases, recently enacted federal school construction programs, if changed slightly through legislation, could offer a big boost to the process of experimentation and innovation.

INNOVATIVE OPTIONS FOR FINANCING NEW SCHOOL CONSTRUCTION AND RENOVATION

Public partnerships with private sector participants for infrastructure investment are becoming somewhat more commonplace in the United States, although Europe and Australia are far ahead of the U.S. in the scope and extent to which the concept is applied. Largely confined to investment in the types of infrastructure that have in the recent past been the full responsibility of government, the partnership concept has been applied to school and university facilities, transit, roads, water systems, airports, wastewater treatment facilities, and ports and harbors.

The term public/private partnership (PPP) is somewhat imprecise, and can cover a variety of arrangements whereby private business joins with a government entity to provide some type of public service to the community. Typically, the public sector provides the exclusive rights to offer the service and may also provide the land, while the private sector participant provides most (or all) of the money, the expertise, and management, and often assumes ongoing operational responsibility. In return for these resources, the private sector receives some kind of financial compensation, often in the form of tolls, rents, or other type of fee arrangements paid by infrastructure users.

In the case of schools, the private partner may receive a lump sum payment for organizing, designing, and building the public school (U.S. system) or may actually own the facility (U.K. system) which it leases to the local school system for monthly, quarterly, or annual rent payments based on the contractual terms of a long-term lease.

These partnerships can also be designed in ways to reduce school system lease costs by allowing the private owner/developer to earn other revenues with the facility, which is common in the United Kingdom and had been in Nova Scotia. For example, the contract could be structured so that the school system leases the building for the hours of, say 8:30 a.m. to 3:30 p.m., Monday through Friday, September to June, as well as select off-hour periods. During the hours and days when the facility is not being used by the public schools, the developer has the right to rent the facility's space to other approved and compatible organizations and businesses.

Such off-hours uses could include for-profit and not-for-profit educational organizations, such as trade schools and refresher programs, day care, community colleges and universities, continuing education programs, civic groups, religious organizations, local governments, political parties, and other similar entities for which classroom, meeting, and auditorium-type space are essential.

Organizations and businesses whose purpose and activities are not compatible with a building primarily used by children would be prohibited from leasing space, and such prohibitions would be clearly defined in the contract. By using the building more intensively than would be the case if its occupancy was limited to just public school functions, the developer and owner of the building can obtain more revenues and earn more profits, and these extra revenues are effectively “passed on to” the public schools in the form of lower rent.

The school system’s lease on each facility could run for several decades with options to renew the lease at the same rent for up to two additional five-year terms. The school system also has the option of buying the facility at a predetermined price if it so chooses, or in some cases may automatically acquire the facility at the end of the lease term. Importantly, the school system has no obligation to rent the facility beyond the initial lease term, thereby providing the developer/owner with a powerful incentive to maintain the building to its highest standard and periodically upgrade it with the latest technology and amenities.

If the original developer is determined to have performed inadequately, the public school can simply contract with another developer for a new facility. Alternatively, if demographic changes in the community lead to a reduction in numbers of school age children, the public school system can simply elect not to renew as many leases as necessary to match facility space with student population, and consolidate the students in the remaining leased facilities. In any case, a well-crafted partnership program allows the school system to shift a number of important technological and demographic risks to the developer/owner, while at the same time enhancing the system’s flexibility and educational choices, all at a lower cost than would be the case if the construction, financing, and ownership were entirely within the public domain.

INITIAL EXPERIENCE IN UNITED KINGDOM, CANADA, AND THE UNITED STATES

The United Kingdom system has the most extensive school partnership program in the world. Open for almost a decade, it began in 1997 as an experiment consisting of a few demonstration projects to see if the concept would work. It did, and as of November 2004, new construction and/or renovations had been completed on 256 school buildings, work was underway on another 291 schools, and an additional 222 schools were in various stages of the procurement process for planned renovation or new construction.⁵

England and Wales Beginning in 1997, the United Kingdom’s Department for Education and Employment (DfEE) began selecting a number of public/private partnership (PPP) school project proposals submitted by Local Education Authorities (LEA) in England and Wales for DfEE financial support. This program was implemented by DfEE as a comprehensive pilot project of nationwide scope to demonstrate the feasibility of alternative forms and techniques of partnerships for school facility improvement. In order to encourage the development and submission of a diverse array of public/private proposals from LEAs, the DfEE offers approved projects a series of financial incentives to facilitate their implementation. The DfEE believes that a program designed to test a variety of different techniques will better determine what works best and what does not, and that

5. November 2004 Project List, Department for Education and Skills, accessed at www.dfes.gov.uk/index.shtml (July 12, 2005).

the lessons learned from these experiments will help guide the development of a more ambitious and comprehensive program in the future.

In keeping with the goal of experimentation across a wide range of public/private approaches, DfEE's approved projects reflect an eclectic mix of techniques and facilities. In addition to many projects involving the construction or renovation of school facilities, approved projects also include a long-term contract to replace the school kitchens in 66 Lewisham schools and provide all school meals, as well as meals for the community's social service programs ("Meals on Wheels", et cetera) for a 10-year period; a joint venture to provide energy repair and supply at more than 120 schools in Stoke-on-Trent; and land swaps with developers of new schools that allow the developer to redeploy the school's former sites for other purposes such as housing. In several of the land swap projects, the estimated value of the land is used to defray some of the costs incurred in constructing the new building, thereby relieving the community's taxpayers of some of the financial burden.

In Nottinghamshire, Walsall, Tower Hamlets, Blackpool, Kent, and Bexley the school developer partnered with both private and public entities to enhance the schools' sports facilities for use by both students and the local community. In Waltham Forest, both the school and a private business will finance and share a music center with practice rooms and a recording studio. In Croydon, a public library will be part of the school. In other cases, local authorities offer real estate developers additional building permits for residential construction in return for financial participation in a PPP school project, as was the case in Cambridgeshire and Hillingdon.⁶

Importantly, an analysis by U.K.'s National Audit Office (NAO) of a sample of various privately financed infrastructure projects found that contractor performance was generally higher than that of governments according to several measures:

In a study of 37 central government projects of various types, NAO found only 22 percent exceeded costs expected by the public owner at the time of contract award. That figure compares to 73 percent of projects with overruns found in a survey of public procurement in 1999. On schedule, 24 percent of PFI projects were late, 8 percent by over two months, compared with 70 percent prior.⁷

Scotland In Scotland, the Scottish Office—the governing body responsible for policy initiatives allowed Scotland as part of its limited home rule—has implemented PFI Scotland (where PFI stands for Private Finance Initiative) to encourage the Scottish government and local communities in Scotland to utilize private financial resources to fund the construction and renovation of public infrastructure such as waste water treatment facilities, hospitals, and "state" schools⁸ through public/private partnerships.

Within a year of implementation, over 70 schools with approximately 50,000 students in eight local authorities, including Scotland's two largest cities, were scheduled for replacement or renovation under the PFI program. Included in the program are all of Glasgow's 29 secondary schools and Edinburgh's 27 secondary and primary schools.⁹ The cost of this 70-school renovation and replacement

6. November 2004 Project List.

7. "Good Marks for PFI Construction," *Public Works Finance*, February 2003, p. 11.

8. In Scotland and elsewhere in the United Kingdom, the term "state school" is the same as a public school in the U.S. Conversely, in the U.K. a "public" school refers to what in the U.S. is called a "private" school.

initiative was expected to total £332 million (U.S. \$554 million), which will be provided by private sector lenders. To encourage these school partnerships, the Scottish Office provides a subsidy to the local authorities to meet the lease payments and operating costs.

Under this program, the Glasgow City Council signed a contract with a construction company that will be given a 30-year concession to improve and manage all of the city's secondary schools. When the offer was first announced in June 1998, formal expressions of interest were received from around 40 businesses within the first week, and these were narrowed down to a group of six qualified bidders who competed for the concession. The concessionaire will upgrade all of the schools within three years, compared to an estimated 15 years under the former, government-run system, and the savings will amount to an estimated 30 percent below what it would have cost the city to upgrade and manage the school facilities itself.¹⁰

Nova Scotia One of the earliest places in North America to adopt the partnership technique for schools was the Canadian province of Nova Scotia, which in 1997 established what it titled the "P3" (public/private partnerships) program.¹¹ With a depressed economy because of a historic reliance on declining natural resource-based economic activities, the province lacked the public revenues needed to build the first-class public schools believed to be the key to its future prosperity. With limited public funds, and with taxes already too high, Nova Scotia turned to the private sector for help, and created an ambitious and comprehensive program to encourage the private sector to build new school facilities that would be leased on a long-term basis to the province's public school system. During the few years the program was in operation, 33 new partnership schools were approved for construction, and 22 of these came on stream at the beginning of the 2000–2001 school year.¹² Unfortunately, a change in government— from liberal to conservative—led to its termination within a few years of its implementation.

United States In comparison to other parts of the world, "public/private partnerships" in the United States—as defined by those arrangements where the private partner has an ownership stake in the facility—are still in their infancy. Although a few innovative experiments have been implemented in several American communities, these tentative steps fall well short of the comprehensive arrangements that now exist for schools in England, Scotland, and Wales. There are two main reasons for our lack of progress in adopting these innovations. First, because most American governments have yet to confront the type of fiscal stress that has been more common in Europe and Canada beginning in the 1980s and 1990s, the vast majority of U.S. municipalities and public school systems have had the financial resources to expand and renovate their school facilities. But in Europe, where taxes are high, and costly social services such as pensions and health care absorb ever larger chunks of government budgets, not much is left over for infrastructure repair or replacement. As a consequence, governments made do with what money they had, at least until

9. "Major Boost for Schools' Buildings from Private Public Partnerships," The Scottish Office, Edinburgh, Scotland, News Release: 2408/98, November 20, 1998.

10. "Scotland Sets Largest Schools Deal," *Public Works Financing*, July/August 1998, p.13.

11. "Building Education: Nova Scotia's Smart New Schools," a brochure published by Nova Scotia Department of Education and Culture.

12. See Ronald Utt, "How Public/Private Partnerships Can Facilitate Public School Construction," Heritage Foundation *Background*, No. 1257, February 25, 1999, pp. 4–6; and "Nova Scotia Schools Fail Lease Test," *Public Works Finance*, November 1999, p. 32; and "Nova Scotia P3 Schools Botched," *Public Works Financing*, July/August 2000, p. 32.

they realized that they could get the private sector to finance the investment if the proper incentives were available.

The second reason is that federal and state governments in the United States offer significant tax preferences for school facilities owned and operated exclusively by public systems, and this preferential treatment has put partnerships with private sector at a costly disadvantage in most American communities. However, despite such obstacles, creative developers and school systems have been able to use what flexibility the laws permit to cobble together a number of innovative partnership hybrids. These projects have allowed several American communities to build their schools faster and for less money than would have been the case under the traditional public construction approach.

One of the first partnership-type schools in America was a develop-design-build-operate public charter school constructed in Pembroke Pines, Florida by The Haskell Company of Winter Park, Florida. The primary school was the first to be completed, and it opened in September 1998. Construction costs were between 22 percent and 34 percent more per student-station than the public primary schools built in Florida during the same period. Despite the requirement that all parents do volunteer work at the school, enrollment was oversubscribed and a waiting list had to be implemented.¹³ Parent interest has remained high, and since the September 1998 opening of the first public elementary school, the community has continued to rely on The Haskell Company for its new school buildings. Since 1998 Haskell has built four pre-kindergartens, four elementary schools, two middle schools, a high school, and a university facility for Pembroke Pines. Included among the projects was an innovative joint use university and high school facility with Florida International University, and an Academic Village that combined a 1,600-student high school with a Broward Community College campus and a regional library as well as an environmental park and city recreation amenities.¹⁴ Unlike the partnerships in the United Kingdom, such partnerships in American communities do not include a private ownership stake in the facility, and may or may not include subsequent involvement in building operations.

In 1998 the Houston Independent School District (Texas), then headed by Roderick R. Paige, President Bush's former Secretary of Education, formed a not-for-profit corporation in partnership with Gilbane Properties of Providence, Rhode Island to construct, under a lease/purchase arrangement with the new corporation, two new high schools. The high schools, each with about 500,000 square feet of space, now accommodate a total of 6,000 students, and have helped alleviate classroom crowding in a fast-growing school district that records 4,000 to 5,000 new students entering the Houston public school system each year.¹⁵ Gilbane contends that the schools were completed a year earlier than would have occurred with the traditional public sector procurement approach, and at a total project cost that was \$20 million below the school district's original estimate.¹⁶

13. See Utt, 1999, p. 9.

14. See Haskell P3 Ventures web site at www.haskellp3.com.

15. "Customer Focus," A Gilbane Properties Inc. Publication, Volume iii.

16. "Point of View: The Public/Private Partnership Concept: An Alternative for School Facility Delivery," presented by Gilbane, 1999, p. 5.

In 2002, the Natomas Unified School District in California partnered with Eastridge Cos., a private real estate development firm, to build the 212,000 square foot, \$58 million Inderkum High School. Using a California state law passed in the mid-1990s, Eastridge is financing the school's construction and, when finished, will lease the school to the school district until the district has the funds to purchase the structure. According to a report on the project:

By using the private delivery method, the district doesn't have to wait for state funding to start construction because Eastridge pays the cost of the building up front. The agreement also means the district can use \$14 million of a \$45 million bond sale, earmarked for the high school's construction, to instead pay for new playgrounds and expanded kitchens at two elementary schools a year earlier than originally planned. Natomas High School also will get its swimming pool and another elementary school will get its library a year ahead of schedule.¹⁷

Elsewhere, many school districts are establishing *de facto* partnerships as they turn to existing vacant, privately-owned commercial space as a quick way of getting needed classrooms. Empty warehouses, stores, and car dealerships are just a few of the privately-owned structures that several school systems have leased or acquired to accommodate exploding enrollments. In Mesa, Arizona, 700 elementary school students began class in August 2000 in a former Smith's grocery store, renamed the Pedro Guerrero Elementary School. In Raleigh, North Carolina, 1,200 middle school students were using a converted manufacturing facility for classes. Two magnet schools in Patterson, New Jersey leased unused space from an empty downtown mall. In Phoenix, Arizona, the Cartwright Elementary School took over the 300,000 square feet of what had once been known as the Maryvale Mall, and shared the space with students from the Marc T. Atkinson School.¹⁸

Another innovative school facilities privatization trend includes the "company school." This term describes the growing number of cases where a major employer in a community provides classroom space to the local public school system in order to accommodate the children of employees as well as any other students in the system if the law requires, or as appropriate. In Miami, Florida, Ryder Systems opened the first satellite charter school adjacent to its headquarters. Initially serving 300 students in kindergarten through third grade when it opened in 1999, the Ryder charter school has since added a fourth and fifth grade and now has an enrollment of 500 students drawn from the children of its employees as well as children living in the surrounding community.¹⁹ NationsBank provides elementary school space to 176 children in Jacksonville, while the Orlando Regional Healthcare System set up a school to serve 60 children of employees in kindergarten through second grade.²⁰ The Miami International Airport established a kindergarten through second grade school for its employees' children. Besides saving the community the cost

17. Anne Gonzales, "Builder Turns Landlord in School Construction Plan," *Sacramento Business Journal*, July, 25, 2003.

18. Haya El Nasser, "Schools forced to roam in search of more room," *USA Today*, August 18, 2000, p. 3A.

19. Richard Seder, *Satellite Charter Schools: Addressing the School-Facilities Crunch Through Public-Private Partnerships*, Reason Public Policy Institute, April 9, 1999; and Lisa Snell, "Workplace Charter Schools: Florida Blazes the Trail," *Reason Public Policy Institute E-Brief*, May 2001, p. 1.

20. "Private Activity Bond School Construction," material prepared by the Office of Senator Bob Graham (Democrat-Florida), October 10, 1998.

of the structure, such company schools also provide a convenient service for working parents, and can easily be combined with workplace daycare programs.

In Scottsdale, Arizona, the superintendent of the city's schools was considering in 2004 a plan to locate kindergarten classes at the facilities of major employers in order to boost attendance. According to one report, the superintendent said that:

the school district, employer, and employee would all benefit. The school district would save money by having the business pick up the tab for teacher salaries and space. The employer could use the on-site kindergarten as a way to attract and keep employees. And employees would have their children nearby.²¹

These examples are, however, a small fraction of the innovative approaches to school facilities solutions that many U.S. school districts have implemented in recent years. The next several sections of this paper review in some detail several of the more promising types of innovations that have been adopted by some school districts, and which lend themselves to replication in other communities. These include:

1. new federal and state legislation to facilitate PPP schools;
2. developer-proffered schools in exchange for zoning variances;
3. a not-for-profit corporation to bridge the partnership;
4. value-creating partnerships; and
5. community development districts.

NEW FEDERAL PARTNERSHIP LAW: PRESIDENT BUSH PROMOTES PPP SCHOOLS

In 1997 then-Senator Bob Graham (Democrat-Florida) and Representative Clay Shaw (Republican-Florida) introduced legislation that would encourage U.S. private investors and developers to construct new school facilities and rent them to public school systems under long-term lease. The Graham/Clay legislation proposed to achieve this goal by allowing private developers to finance the new school building with tax-exempt private activity bonds, thereby giving them essentially the same favorable cost of capital available to the public sector. With access to preferred borrowing rates, these developers would lease the facilities to public school systems at annual costs below what communities would incur if they built the schools on their own. Although Congress did not enact Graham's proposal, then-Governor George W. Bush endorsed it in his run for the Presidency and included it in his platform.

Once in office, President Bush and Members of Congress worked to include the proposal in Section 422 of the new Economic Growth and Tax Relief Reconciliation Act of 2001 that was passed on June 7, 2001.²² Until then, the ability to issue bonds whose interest is exempt from federal taxation was largely limited to state and local governments—an important benefit that allowed

21. Anne Ryman, "Kindergartens in Workplace?" *The Arizona Republic*, November 23, 2004.

public entities to borrow at interest rates about a third lower than what individuals or private companies would pay on their borrowing. As a result of the privileged tax-exempt status for state and local government borrowing, the private sector was at a significant, though artificial, cost disadvantage whenever it attempted to work with communities to construct and own public infrastructure such as schools, roads, waste water treatment plants, and airports that, in turn, could be leased back to the community.²³

The 2001 tax bill attempted to end that competitive disadvantage for public school facilities by extending the tax-exempt borrowing privilege to developers willing to invest their funds in ways that will help end the classroom shortage in fast-growing, but cash-strapped suburban communities, or replace and renovate obsolete and deteriorated inner-city schools in financially-troubled cities.

How the New Legislation Works Under this new approach, a public school system can negotiate with a developer to build a public school facility, in accordance with designs and standards set by the community or state. In turn, the developer leases the facility to the school system under a long-term arrangement at a pre-determined rent. Whereas the developer/investor would be responsible for the physical structure of the public school, the school system would still operate the school with its own teachers and administrators, curricula, educational guidelines and standards, and other such requirements pertaining to the educational process. The new law also requires that the lease term coincide with the term of the tax-exempt bonds issued to finance the facility, and that at the end of the lease term the physical structure must automatically become the property of the public school system. As it turns out, the tax implications of that last provision has made the new law virtually impossible to use, as will be discussed later.

Although the extension of tax-exempt borrowing privileges to partnerships for public schools represents an important reform, giving public school systems and communities greater choices in financing and building their education facilities, the law's statutory limits on the dollar volume of such bonds that can be issued each year would restrict its use to slightly less than \$3 billion of new school construction per year. Under the new law, a state may annually issue bonds up to a dollar volume limit total equal to \$10 multiplied by the state's population. Virginia, for example, with a population of 7 million, could issue as much as \$70 million in such bonds per year, an amount sufficient to build two large suburban high schools. California could issue as much as \$338 million per year. Nationwide, approximately \$2.7 billion of these bonds could be sold to fund the construction of partnership public schools.

As a result of these volume caps, the new legislation would essentially create a national demonstration project that allows a limited number of communities to experiment with the new concept and prove its viability and versatility. Once the program's success and popularity are evident, Congress would likely increase these caps to expand the program because this innovative approach offers a number of significant financial advantages to public school systems, and also provides

22. Section 422 is nearly identical to legislation introduced in the 106th Congress by Senator Bob Graham (Democrat-Florida) and Representative Clay Shaw (Republican-Florida) titled the Public School Construction Partnership Act (S. 526 and H.R. 2514).

23. Ironically, tax-exempt financing available through another federal program had been used to construct facilities for private schools. See "Panel Backs Tax-exempt Bond for School," *The Washington Post*, March 23, 2000, p. B3; and Andrea Billups, "Private School Bonds to be OK'd," *The Washington Times*, February 17, 1999, C3.

communities with opportunities to reach levels of quality otherwise beyond a typical school's budget. Unused annual state allocations under the cap can be carried forward into the next year. But because of technical flaws in the legislation that reduced the program's appeal to developers and school systems, much of the \$3 billion permitted for 2002 will carry over into 2003, allowing for as much as \$6 billion in school construction to be financed with partnerships. After three years, however, the carryover allocations expire, unless the flaws are remedied.

Although the enactment of the new legislation was greeted with enthusiasm by advocates of privatization and partnership schools, it was soon discovered that some drafting errors in the original legislation rendered the new law largely unworkable. To date, few if any new schools have been built using the partnership/private activity bond approach the legislation allows. According to tax lawyers, Section 142 of the Internal Revenue Code contains the following two flaws that hinder the use of the program, the first of which is probably fatal to the program:

Section 124 includes a provision for mandatory transfer of ownership from the for-profit entity to the school district at the end of the partnership agreement. That requirement leads to the contradictory conclusion that the school district is the owner for federal tax purposes during the entire term of the partnership agreement rather than solely after the conclusion of the agreement. As a consequence, the for-profit "owner" is unable to write off the annual depreciation against taxes. Combined with the absence of any recovery value at the end of the agreement, these provisions make for an unattractive investment, and would necessitate high lease payments by the school district.

The statute unnecessarily limits the field of potential investors by allowing only a for-profit corporation to enter into a partnership agreement with a public education agency, thereby excluding potentially interested private parties such as an individual, a trust, partnership, or limited liability company to participate.

Some privatization advocates are attempting to amend the law to eliminate the flaws, and Representative Clay Shaw, one of the original sponsors of the legislation, asked the Joint Committee on Taxation in early 2005 to review the recommended amendments to determine whether a change in the law is feasible.

State Enabling Legislation At present, and perhaps with only one notable exception, few states have enacted the legislation that may be necessary to allow school districts to work in innovative ways with the private sector to finance and construct school facilities, or to allow the school districts to lease such facilities (other than mobile classrooms) from private sector investor/owners. Several states—notably Florida and Arizona—with very accommodative charter school laws, have in some cases indirectly created an emerging market for leased facilities from the private sector. Both of these states make it relatively easy to establish a charter school, and provide that school with a set per-pupil fee to finance the operations of the school, including some amount of money to cover the capital costs related to infrastructure acquisition.

What the states do not provide is a facility in which to operate the charter school, leaving most charter schools on their own to find suitable space. In many instances, this has led the school to lease existing space from the private sector (often reconverted commercial space), or to work cre-

actively with developers to build and manage the school, which remains publicly-owned and financed by tax-exempt debt issued by the community (Pembroke Pines, Florida). Because of Florida's robust charter school program, a number of Florida residential builders and developers have used the flexibility of this program to provide communities with turn key educational facilities in lieu of impact fees or some other form of growth limit. Included in the section on developer proffered schools are examples of how Florida's charter school program has been creatively used to facilitate residential development.²⁴

In contrast to the creative use of Florida's charter school program to overcome locally imposed infrastructure hurdles, the state of Virginia recently enacted the Public-Private Education Facilities and Infrastructure Act of 2002 (PPEFIA).²⁵ According to the Model Procedures the state has provided to communities a series of commonsense guidelines to follow whenever they are soliciting developer interest in partnership arrangements for public schools.

The PPEFIA grants responsible public entities the authority to create public/private partnerships for the development of a wide range of projects for public use if the public entities determine there is a need for the project, and the private involvement may provide the project to the public in a timely or cost-effective fashion. The PPEFIA defines "responsible public entity" to include any public entity that "has the power to acquire, design, construct, improve, renovate, expand, equip, maintain, or operate the applicable qualifying project." Individually negotiated comprehensive agreements between an operator and a responsible public entity will define the respective rights and obligations of the responsible public entity and the private operator.

The PPEFIA contains a broad definition of qualifying project that includes public buildings and facilities of all types. For example:

An education facility, including, but not limited to, a school building (including any stadium or other facility used for school events), any functionally-related and subordinate facility and land to a school building and any appreciable property provided for use in a school facility that is operated as part of the public school system or as an institution of higher education...²⁶

As of early 2003, the Act had spawned direct action and serious interest in several Virginia school districts. Fairfax County, the state's largest, has been investigating the feasibility of such schools for several years, and the passage of the Act intensified the effort.

In early 2003, Virginia's Stafford County, one of the state's fastest growing counties and an ex-urb of Washington, D.C., decided to test the interest and capability of private developers to build, and lease to the county, two elementary schools and a high school to accommodate the expected growth in the student population. The county specified its basic needs, identified the site, and encouraged interested partners to make an attractive offer. After discussion with several groups, a

24. At least one California-based Real Estate Investment Trust had added charter school facilities to its equity portfolio in the late 1990s, and some industry experts suggest that Real Estate Investment Trusts dedicated to public school facility investment could be a future possibility.

25. Virginia Code Section 56-575.1 through Section 56-575.16.

26. "Public-Private Education Facilities and Infrastructure Act of 2002, Model Procedures," September 30, 2002, p. 4.

formal competition took place between two private sector teams, and in late May 2003, the county accepted the team of Haskell/Hess to be its partner.

In winning the bid, Haskell/Hess offered the county an extraordinary package of services that will provide the citizens of Stafford with much more than just three new schools, and at a cost several millions dollars less than what the package would have cost the county under traditional practices. In winning the bid, Haskell/Hess proposed to team with three public universities and colleges, the YMCA, the public library, a day care service, and a developer of retirement communities to build a multi-purpose facility that will provide Stafford County with much more than just a couple of public schools.

The three Virginia college partners will use the high school classrooms (or other on-ground facilities) during after school hours and weekends to serve continuing education students. The public library would partner with the high school in a combined library that would also serve as a branch library for the community at large. The YMCA would partner with the school in building and operating multi-use recreational facilities. And by utilizing a portion of the site (28 acres) for a 200-unit retirement community, Stafford gains revenue from the sale of the land, and from the property taxes ultimately levied on the completed housing units and the for-profit day care center. Further, it is expected that the nearby retirement community would generate volunteer mentors and tutors to help out at the schools.

According to a recent report on partnership schools by the Appleseed Foundation, Maryland created a state-commissioned Task Force to Study Public School Facilities in 2002. Members of the Task Force reviewed Virginia's PPEFIA and recommended that Maryland adopt similar laws. As the report notes:

The Maryland Task Force also encouraged the state legislature to enact provisions similar to the ones contained in PPEFIA that permit the use of private activity bonds authorized by the federal Economic Growth and Tax Relief and Reconciliation Act of 2001. As a result of the Maryland Task Force's work and the efforts of others, Maryland lawmakers introduced bills in the Maryland House of Delegates and Senate known as the Public Schools Facilities Act of 2004 (H.D. 1230 and S. 787) to address school facility financing issues. The legislation passed in both Chambers of the Maryland legislature at the end of the 2004 session in April, and Governor Robert L. Ehrlich signed both bills in May 2004.²⁷

FINANCIAL AND OTHER BENEFITS OF PUBLIC/PRIVATE PARTNERSHIPS

Implementation of public/private partnerships for schools in Europe, Canada, and the United States has already demonstrated significant advantages over the traditional public sector construction approach. These advantages include the following:

First, unencumbered by the multitude of regulations that govern public sector bond offerings, voter approval, design reviews, review of competitive bids, and construction, public schools

27. "Need Space? School-Facility Public-Private Partnerships: An Assessment of Alternative Financing Arrangements," The Appleseed Foundation, Washington, D.C., 2004

can be built in a much shorter period of time than with the traditional method. One partnership school in Florida was designed and built in less than nine months compared to an average of five years for traditional public elementary schools built in the state.²⁸

Second, by relying on the expertise and the competitive efficiencies motivated by the profit incentive, construction costs will generally be much lower than public sector construction costs. Recent private sector performance in building and owning waste water treatment plants and other infrastructure including schools suggests that cost savings could average around 25 percent to 30 percent over what it would cost the public sector.²⁹

Third, by opening up all facets of the project—conceptual, design, construction, building management—to competition, the community is exposed to innovative approaches to public infrastructure that go beyond just the benefits that would accrue to the school system. In a number of partnerships here and abroad, developers have created ways in which school facilities can provide greater benefits at lower costs to the community by allowing a greater mix of other public activities such as libraries, recreation, and continuing education within a public school complex.

Fourth, public school systems will experience additional savings through the partnership approach because they are leasing the building for only a portion of the time that the facility is available for use. For the most part, a public school system uses its classroom facilities for only about nine months of the year, Monday through Friday, and from early morning to mid-afternoon. This situation leaves unused classroom and auditorium space available for rent in summer, on weekends, and in late afternoons and evenings during the week. By allowing the developer/investor to earn additional rent by leasing unutilized space to other, compatible lessees during off-hours, the resulting savings can be passed on to the public school system in the form of a lower rent that better reflects the system's part-time claim on the use of the classroom facilities.

This last point is of particular importance, not only because of the potential for additional cost savings (and rent reduction), but also because of the additional benefits and convenience that a more intensively used school facility can provide a community. These supplemental uses must, of course, be compatible with a facility that primarily serves the interests of children, and would, for the most part, be contractually limited to other educational and civic purposes.

One likely use would be day care services before and after school, where private, licensed providers would lease space from the school facility owner to provide day care services to the parents of children attending the school. Advantages of such an arrangement would include improved safety and convenience. Once the school day is over, working parents would no longer have to worry about how to safely get their children from school to the day care provider because competing, private providers could rent space within the building. Under such arrangements, the child would have to do nothing more complicated than walk down the hall from his or her last class to the room where the day care service of parental choice rents space each day.

28. Lisa Snell, "Workplace Charter Schools," p. 1.

29. "Full Service Charter School Opens," *Public Works Financing*, July/August 1998, p. 13; and Ronald D. Utt, "Improving Government Performance Through Competitive Contracting," *Heritage Foundation Backgrounder* No. 1452, June 25, 2001, p. 8.

Another possible use would be for supplemental education programs offered by for-profit or not-for-profit organizations, and covering subjects not ordinarily part of today's public school curriculum. Such subjects could include computer programming and technology, advanced art and music instruction, advanced sciences and math, and language classes, as well as otherwise commonplace academic subjects sometimes not covered in today's public schools, such as geography and history. Culture and language courses serving the children of ethnic minorities in the community would be suitable subjects for after-hours instruction, as would the drivers' education courses that many states require for obtaining a driver's license.

In the evening, classroom space could be used for a variety of adult education purposes, for-profit or not, and could cover academic interests as well as cultural enrichment, hobbies and crafts, home repair, preparation for GED exams and standardized tests for entry into college or professional schools, and other general educational purposes. Evening space could also be leased to local universities and community colleges short on classroom facilities.

Off-hours space could also be leased for a variety of civic uses, including meeting space for community-oriented clubs and organizations, political parties, boys and girls clubs, and Boy Scouts and Girl Scouts. Because the structure is privately owned, civic groups would be less likely to confront prohibitions based upon prejudice and political correctness, a problem that is now sometimes the case with public facilities.

Depending upon community preferences, a lease agreement could be structured to allow for local religious institutions to rent space after hours and on weekends to provide religious instruction that heretofore could only be offered in off-site classroom space owned by churches, mosques, and synagogues, or in space rented from private landlords. The reason for the exclusion of religious groups from public buildings in some communities followed from First Amendment sensitivities and the belief that the separation of church and state precluded religious use of public facilities.³⁰ Under such an arrangement, children could receive religious instruction after school hours in the same building, thereby promoting convenience and safety by eliminating the need for additional offsite travel. Rabbis could offer Hebrew lessons, local priests could conduct confirmation classes, church choirs could practice in the music room, and other similar forms of religious instruction and training could be offered. Adult classes on the same themes and purposes could be conducted at night for working parents, while classroom and auditorium space could be leased on weekend days of the Sabbath to religious groups that had not yet acquired, or could not yet afford, their own facility.

Importantly, and depending upon community standards and preferences, a school system could also require, as part of the initial lease agreement, that religious groups not be allowed to use the facilities after hours or on weekends. As a private facility, constitutional mandates or prohibitions would not be applicable either way.

30. However, a recent ruling by the U.S. Supreme Court found that such exclusions on religious grounds in fact violated the Constitutional right to freedom of speech, and that public schools could not exclude after-hours religious use if other non-school civic groups were provided that privilege. See Supreme Court of the United States, *Good News Club et al. v. Milford Central School*, Certiorari to the United States Court of Appeals for the Second Circuit, No. 99-2036. Argued February 28, 2001; decided June 11, 2001.

Mixed Use Innovations in the United Kingdom Because the basic private/public partnership concept is so flexible, a number of other innovative, sub-contracting arrangements could be devised and encouraged to satisfy a community's educational and service needs, as can be illustrated by some of the creative developments and proposals adopted in England and Scotland in response to partnership opportunities. In one case a school in Waltham Forest, England used the partnership approach to acquire a state of the art music facility that it otherwise could never afford. To accomplish this aim, the school offered a private company a discount on rent and other expenses in return for building within the school a new music room, high tech audio/visual lab, and recording studio. From Monday to Friday during the school day the public school students use the facility and its advanced equipment, but after hours and on weekends the facility reverts to the owner/investor who leases it for commercial purposes on a for-profit basis.

In another similar innovation, 66 schools in Lewisham, England used a partnership to upgrade and renovate their cafeteria kitchens to modern, commercial quality level and provide school meals for a 10-year contract period. These kitchens will also provide meals for other not-for-profit and social service purposes such as Meals-on-Wheels. Other uses could extend to a public nursing home, the jail, a homeless shelter, and other public and/or charitable purposes. As a result, the schools get much-needed cafeteria upgrades by spreading the renovation costs among several public service entities, while all groups benefit from a reduction in per unit operating costs through more intensive and efficient use of the facility and its work force.³¹

Improved sports and recreational facilities represent another area of activity where British schools have creatively used partnerships with private sector investors to obtain needed upgrades. Schools in Tower Hamlets incorporated new athletic facilities as part of a school renovation with a private partner. Similarly, Canterbury High School in Kent partnered for a new athletic track and gymnasium, while the Collegiate High School in Blackpool last year signed a contract with a private business to provide an indoor sports center that students use at no charge during school hours. At other times when school is not in session, businesses will offer the facility for lease.³²

If applied in America, this concept of "subcontracted partnerships" could be used to encourage these same kinds of educational upgrades. One such opportunity available to schools that have fallen behind in upgrading educational technology would be for a public school to contract with a private business to fund, build, and operate a state of the art computer lab. During the day the lab would be used exclusively by the public school students and teachers, but in evenings and on weekends, the private business would operate it as a for-profit computer learning center serving adults and others. Revenues earned in off-hour use would offset costs incurred in providing service to public school students.

Alternatively, if the community was reluctant to share a public facility with for-profit groups, or if the location was such that for-profit groups would have little interest, subcontracting or partnerships could be arranged with other public entities. Fast-growing communities need a variety of infrastructure, including libraries, community colleges, continuing education, and sports and recreation. Typically, these services are provided by separate facilities, which are often underutilized

31. Public/Private Partnership (PPP) Projects in Schools: Project List, Department for Education and Employment, September 1998.

32. Public/Private Partnership (PPP) Projects in Schools: Project List, Department for Education and Employment, May 2001.

during certain parts of the day, week, or year. But with a little forethought and advance planning, many of these entities could be combined in a single facility or campus. For example, with a couple of design changes, the school library could easily be doubled up with the public library, or as a branch of the local public library system, thereby saving on the costs of duplicate facilities, books and periodicals, operating expenses, staff, and management. High school classrooms could easily support community college students and continuing education in the evening and weekends, while the school gym, pool, and playing fields could serve community park and recreation needs. In any event, such facility sharing could reduce the infrastructure costs associated with population growth. As noted earlier, the Stafford County partnership with Haskell/Hess included dual use of many of the facilities by public, private, and not-for-profit entities.

DEVELOPER PROFFERED PUBLIC PARTNERSHIP SCHOOLS

Privately constructed and owned public schools have received a boost from the escalating concern in some communities over the higher costs that many believe rapid population growth will impose on local taxpayers. New homes mean new families, and new families mean more children for the schools. In the fast-growing ex-urbs of many metropolitan areas, the increase in students has led to crowded schools as school systems have failed to sustain construction programs to match the growth in enrollment. Worried about the cost such enrollment growth may impose on local taxpayers, many communities are looking for ways to limit growth or to impose “impact” fees on builders and new homebuyers.

While restrictions, limits, and fees are often the typical response to suburban growth concerns, a number of communities have welcomed innovative partnerships that have allowed for growth while keeping public infrastructure costs in check. In California a new state law allows homebuilders to provide the community with a school in lieu of the impact fees that would otherwise be charged for each new home built. One of the first to take advantage of the law was Corona, California, which in December 2000 was provided a new elementary school by a developer adding 1,200 new homes in the community.³³ A similar exchange occurred in the suburbs of Denver where homebuilders have agreed to build new public schools in the new subdivisions they construct in return for permission to build additional houses in the community. Some Florida developers have provided schools in order to develop sections of the municipality that were not scheduled to receive new school construction funding for another decade.

With a number of new innovations to build, finance, and lease new public schools faster and cheaper than conventional methods, such infrastructure obligations may be easier and less expensive for developers to fulfill, and many will be inclined to enter the school facilities business. In turn, this will lead to better, albeit less expensive, school buildings, and allow the school system to concentrate its energies where it can make the most difference—in educating children.

Fast growing suburbs, deteriorating cities, and a demographic (echo-echo) boom of school-age children have left many communities struggling to provide adequate classroom space. Although there are many reasons why some communities have fallen behind, a common cause of the delays and the shortfall is the cumbersome public sector construction process that can take as long as

33. *Privatization 2001: The Fifteenth Annual Report on Privatization*, Reason Public Policy Institute, 2001, p. 25.

five years to fund and build a public school, compared to as little as a year or less for the private sector to accomplish the same task.

Several other similar projects have also been undertaken in a number of Florida communities. A 12,000 acre retirement community called The Villages developed a series of public charter schools covering kindergarten through high school to serve the children of the employees who work at The Villages (discussed in more detail below). Another similar project was recently completed in an Orlando, Florida residential development, where the developer agreed to provide a facility that included an elementary school, a YMCA, and Community Wellness Center located on land that also serves as the “city park” in return for the right to construct a high-density 900 unit residential development in a 500 acre New Urbanist community.³⁴

In late 2004, a developer in Frederick, Maryland proposed to fund the construction of an \$8 million addition to the local high school in return for approval of a 763 unit housing development south of the city.³⁵ Even in the United Kingdom, the partnership program allows for various arrangements between homebuilders and schools in exchange for additional building permits, and two such arrangements occurred recently in Cambridgeshire and Hillingdon.

CREATING A NOT-FOR-PROFIT CORPORATION FOR TAX-EXEMPT BORROWING

Although the new law allowing for the first extension of tax-exempt, private activity bonds for public school construction is not yet fully operational, several communities and developers have already created and implemented a number of innovative arrangements that allowed for the tax-exempt financing of hybrid partnership schools through not-for-profit corporations called “63-20 corporations”, named for the section of the IRS code that permits them. Such arrangements generally included substantial up-front involvement from the private developer, but ownership of the completed facility, and any revenues there from generally remain with a not-for-profit corporation, or foundation, established to facilitate the transaction, or with the school system. Two high schools that were constructed in Houston, Texas by Gilbane Properties in 1999 were accomplished through the creation of a not-for-profit corporation that issued the tax-exempt bonds, managed the construction project, and took title to the facilities upon completion. The purpose of establishing this arrangement was to circumvent the electorate’s repeated refusal to approve a general obligation bond offering to construct the schools. In turn, the Houston schools system pays annual lease payments to the not-for-profit, which in turn uses these funds to service the debt it incurred to build the schools. As noted earlier, Gilbane believes that the many advantages and efficiencies of this arrangement led to savings of as much as \$20 million off the cost that would have been incurred had the schools been constructed under the more conventional arrangements.

A substantially larger school construction project using a similar innovative arrangement for similar reasons was undertaken on behalf of Greenville County School District (the largest in South Carolina with 60,000 students) by a consortium of developers working in cooperation with the school system to build new schools and renovate several existing ones. Similar to the situation in Houston, the district was unable to finance the program through conventional means because it

34. See www.glatting.com.

35. Frederick Kunkle, “Builder’s Offer Prompts Skepticism,” *The Washington Post*, November 7, 2004.

was near the state-imposed debt limit, and would have had to seek voter approval to exceed those limits. Instead, it created a not-for-profit (63-20) entity called Building Equity Sooner for Tomorrow (BEST) to issue \$800 million of tax-exempt Installment Purchase Revenue Bonds, and use the proceeds to renovate 50 existing schools, construct 22 new schools, and devote \$10 million to technological improvements in instruction and administration.

To manage this ambitious project, a limited liability company called Institutional Resources was created and jointly owned by the several major development companies involved in the project. As the project's manager, Institutional Resources provides services related to development, financing, design coordination, project management, and construction management. The \$800 million in bonds were issued in March 2002 and construction is underway. The school district will purchase the completed projects from BEST under an installment purchase agreement, in semi-annual installment payments to BEST in amounts sufficient to pay debt service on the bonds.

VALUE-CREATING ENTREPRENEURIAL PARTNERSHIPS

A particularly innovative private/public partnership with interesting applications to a wide range of development situations occurred in 2001 in Washington, D.C. when LCOR Incorporated, a national real estate development company, teamed up with the District of Columbia Public Schools to rebuild the James F. Oyster Bilingual Elementary school, a 47,000 square foot state of the art facility costing \$11 million, and the first new school built in the District in 20 years. Under this innovative public/private partnership, the cost of constructing the school was financed with an \$11 million, 35-year tax-exempt bond package issued by the District of Columbia. These bonds, in turn, will be repaid entirely from revenue generated by a 211 unit, \$29 million, apartment building that LCOR and its partner constructed on excess public land adjacent to the school.³⁶

As structured, the District and its taxpayers will pay nothing for the school. Using underutilized land owned by the school, LCOR and its partner, Northwestern Mutual Life, created value and revenue by constructing a luxury apartment building (The Henry Adams House) on vacant public land. In turn, the \$11 million in tax-exempt bonds issued to build the school will be serviced by means of PILOT (payment in lieu of taxes) payments made by the apartment building partnership, which in effect generated the additional tax revenues to build the school.

LCOR believes that this type of partnership is replicable in many communities throughout the country. According to one of its officers: "The Oyster approach is innovative but also highly replicable. Government entities, including school districts across the country, own trillions of dollars of land, a significant part of which is underutilized. Projects such as this one offer a way for governments to unlock the value of their underutilized land."³⁷

One potential variant of this approach would be to link a variance for higher density development, or the goal of creating more affordable housing, with additional school facilities as part of an overall residential development package. Such a partnership of goals would be particularly relevant in those communities that require, reward, or encourage residential developments above

36. See description at www.lco.com/oysterschool1.html

37. *Privatization 2002*, The Reason Foundation, pp. 27–29.

some size to dedicate some portion of housing units to be constructed for moderate income households. Under such circumstances, in what might otherwise be a development of only single-family detached homes, an arrangement might be made where, as part of the permission to do the project, the developer could replicate a version of the LCOR/Oyster approach.

For example, on a specific parcel within or contiguous to the development, the developer, perhaps in partnership with other investors, could build an apartment building and a public school on the same or an adjacent site. As with the District of Columbia case, a portion of the revenues produced by the rental apartment units would be allocated to service the tax-exempt debt incurred to build the new school in the form of a payment in lieu of taxes. Under such an arrangement, the community obtains a new school at no net new cost to the taxpayers, while at the same time meets its goal of increasing the supply of affordable housing to its citizens of more modest means. Because several states (California and Hawaii) allow for the inclusion in locally-levied impact fees an “inclusionary fee” or “affordability fee” to fund moderate income housing, an arrangement such as the one described above could be attractive to many communities where inclusion and affordability are explicit community goals.

Under such creative arrangements, the builder is able to provide these structures at minimal additional costs to himself by partnering with the community to create additional value (and revenue) through higher densities that might otherwise have been permitted under current zoning. While the LCOR example and the above discussion assume multiple use of a single parcel, or contiguous parcels for the school and the multi-family units, there is no reason why they would have to be near each other. Indeed, under most circumstances any available lot within the boundaries of the jurisdiction, public or private, would be suitable. The key is to use the developer’s entrepreneurial talents to create value in and for the community that might otherwise not occur.

COMMUNITY DEVELOPMENT DISTRICTS

Although not quite the sort of privatization or partnership arrangement that characterize the service delivery mechanisms discussed in the preceding sections, community development authorities can be viewed as quasi-governmental entities that state law may allow the private sector to create in order to provide the property owners within the boundary of the authority or district a limited number of public services, usually those derived from infrastructure such as sewer and water, roads, and storm water collection. In turn these authorities and/or districts generally fund those services by levying a tax surcharge, and/or other fees, on the properties that lie within the district or authority. Sanctioned by state law where permitted, and essentially public in nature, these districts are often permitted the right to issue tax-exempt debt to fund the infrastructure they build. The tax surcharge, and other fees and revenues, are set at a level to service the debt and cover any administrative fees. Indeed, it is the ability to issue tax-exempt debt to finance a development’s infrastructure that is one of the more attractive reasons why developers and property owners are now creating these districts and authorities. In effect, this process may be viewed as the converse of privatization, a “governmentization” so to speak of certain development activities and costs, or, conversely, a privatization of certain government functions.

With laws permitting these districts no older than a decade or two in most states, it is estimated that as many as 30 to 47 states (depending on how the term is defined) now allow the creation of such districts. Depending upon the enabling law, these districts vary in what services they are per-

mitted to provide, how they can be formed, who can join, how they raise revenues, how autonomous they can be from the local municipality, and to what purpose their creation may be limited.

In Florida, the law permitting the general creation of Community Development Districts dates to 1980, although several were created prior to this by special acts of the legislature. The community development district encompassing Disney World near Orlando was one of the nation's first such districts and was created by an act of the Florida legislature. Since 1980, the permission to create a district can be granted by the municipal government for districts of 1,000 acres or less, or by the governor if the district is larger than 1,000 acres.

One of the more ambitious uses in Florida of the CDD concept is by a retirement development called the Villages. Located west of Orlando and extending into three counties, the Villages has created seven separate CDDs that span the community and provide a variety of public services to the businesses and residents living within their boundaries. These services include wastewater treatment, water supply, storm water management, a security force, roads and trails (for walking and golf carts), basic public administration, fire protection, first response emergency service, streetlights, and recreation and parks. Revenues to fund these services are derived from a variety of fees, surcharges, and taxes levied on businesses and residents operating and living within the Villages.

Although built as a retirement community, the Villages workforce (employees of the Villages or CDDs) numbers near a thousand, and the workers' children attend charter public schools built, financed, and owned by the corporation that developed the Villages. Though the facilities are privately owned, per student operating costs are covered by the state under Florida's liberal charter school law. The Haskell Company of Winter Park Florida was the partner in this effort, and since 2000 it has designed and constructed a K-5 elementary school, a 6-8 middle school, an early childhood center, a K-2 primary learning center, and a combination high school, gymnasium, and an art and music enrichment center for the Villages.

To date, and in many states other than Florida, developer creation of these community development districts and authorities has been limited, partly because of the newness of the law. Virginia's enabling legislation was first passed in 1995 but not fully operational until amended in 1997. The first CDA was not created until 1998, and initially all of the Virginia CDAs had been created to facilitate large-scale commercial developments such as shopping centers or hotel/resort/mixed-use commercial. But in the last few years several have been created to serve largely residential developments: two in Prince William County in Northern Virginia, and a third in Hanover County north of the City of Richmond.

Under the Virginia law, the CDA must be approved by the municipality, but any tax-exempt debt it issues is its own obligation and not that of the permitting municipality. These CDAs are governed by a Board appointed by the property owners within the authority. Revenues to service the debt and provide other services within the CDA can be provided by a special assessment on property (up-front or over time), a special property tax (limited to \$0.25 per \$100 of assessed value, but can be higher if approved by property owners), fees and charges for services, and other revenues that might be available to the CDA.³⁸

38. See www.mcguirewoods.com/departments/financial_services/public_finance_4.asp for summary description of VA CDA provisions and activity.

In 1994 Maryland enacted legislation to authorize the creation of similar special taxing districts in 10 of the state's 24 counties for the purpose of shifting any new infrastructure development costs directly on the new residents and businesses within the new development and allowing the developer to pay for that infrastructure with tax-exempt debt issued by the municipality. Although first enacted in 1994, as in the case of Virginia it took a series of amendments added in 1996 and 1997 to make the program workable. Woodview Village (Prince George's county), built in 1997, was the first development to use the process. Whereas many of Virginia CDAs had initially been created to serve commercial development (hotels, shopping centers, et cetera), the Maryland districts that have been created to date largely to serve residential developments (Woodview Village, Farmington Village), mixed use (Kingsview Village Center, Urbana Community Development Authority), or commercial (Arundel Mills).³⁹

Unlike the Virginia CDAs, which issue their own bonds, bonds issued on behalf of the Maryland CDAs are issued by the county in which the special district lies and that approved its creation. These bonds are then the obligation of the municipality, not the special tax district, and they are serviced by an *ad valorem* tax or a special assessment levied on the property owners within the district and collected by the municipality as part of the normal property tax collection process. In some cases these districts are created to fund infrastructure the developer (and builder) would normally be expected to provide (roads, utilities, sewer, storm water), but in others they may include additional charges to service debt incurred to fund infrastructure outside the boundary of development and district, but which will serve the new residents of the community. Bonds issued on behalf of the Woodview Village district also fund a monetary contribution for the design, construction, and extension of improvements to public schools serving the district.

For those improvements to infrastructure lying within the district such as roads, utilities, and sewers, the Maryland CDA offers the advantage of lower cost tax-exempt borrowing to provide infrastructure that the developer would otherwise have to provide anyway (with taxable debt). Instead of having to add the pro rata cost of such infrastructure to the price of each house and letting the buyer finance it as part of his or her first mortgage, the county finances it instead, and the per household pro rata share of the debt service is covered by an *ad valorem* tax on the property. In theory and in perfect markets, the CDA approach should involve less cost to the homebuyer by virtue of the tax-exempt financing that would otherwise not be available to the developer/builder.

The origin of these special districts dates back to the late 1970s in California when the passage of Proposition 13 induced municipalities, and builders, to look for alternative sources of funds to pay for infrastructure. That search led to the creation of special taxing districts (called Mello-Roos districts to fund infrastructure). Since then, California developers have raised an estimated \$20 billion dollars through these districts to fund infrastructure, and an estimated 90 percent of all planned unit developments in the state utilize Mello-Roos districts to fund infrastructure within the development.

39. See John Orrick, "Special Taxing Districts: A Public/Private Development Tool for the New Millennium," at www.linowes-law.com/documents/special_taxing_districts.cfm http://www.linowes-law.com/documents/special_taxing_districts.cfm for more information on Maryland CDAs.

CONCLUSION

Fast growing suburbs, deteriorating cities, aging school buildings, and a demographic (echo) boom of school-age children have left many communities struggling to provide adequate classroom space. Although there are many reasons why some communities have fallen behind, a common cause of the delays and the shortfalls is the cumbersome public sector design and construction process. The traditional process can take as long as five years to fund and build a public school, compared to as little as a year or less for the private sector to accomplish the same task, often for less money. Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 could address that problem for some school districts by allowing a limited number of communities to transfer the responsibilities of financing, building, and owning public schools to private sector investors who will lease schools to communities. However, until the law is corrected, it is unlikely that many school districts or developers will use the process to the full extent that the bond caps would allow.

As has been demonstrated in the U.S., Canada, and United Kingdom, private/public partnerships that harness the talents and resources of private entrepreneurs offer the prospect of satisfying more community needs and building less expensive schools in shorter periods of time than is currently possible with traditional public management and funding. Under the conventional school construction process, the public school system attempts to be both educator and real estate developer, and sometimes performs inadequately at both functions as limited resources and specialized talents are spread thinly among disparate endeavors. Through public/private partnerships the school system can focus strictly on the core business of education while for-profit developers focus on delivering much needed community facilities. When implemented to its fullest, such a system of partnerships could yield better buildings, better education, and better communities.