

(Date)

(SENT BY EMAIL)

The Honorable Elizabeth Steiner Hayward, Co-Chair
The Honorable Dan Rayfield, Co-Chair
Interim Joint Committee on Ways & Means
900 Court Street NE
H-178 State Capitol
Salem, OR 97301-4048

Re: Budget Note Report on Clackamas County Courthouse Project

Dear Co-Chairpersons:

Nature of the Request

A budget note to 2021 House Bill 5006, set out below, requested a report to this committee prior to the 2022 legislative session to respond to several questions related to the Legislature's authorization of \$94.5 million in state bonds to help finance a new courthouse in Clackamas County, and as a prerequisite to the Legislature approving an increase in Other Funds expenditure limitation to allow the sale of the state bonds.

Budget Note

"The Oregon Judicial Department (OJD), in coordination with Clackamas County, is requested to submit a report to the Joint Committee on Ways and Means, prior to the legislative session in 2022, on the design, build, finance, operation, and maintenance public-private partnership (P3) agreement(s) for the Clackamas County Courthouse, as well as the funding agreement between OJD and Clackamas County, related to constitutional and statutory requirements for state support and local matching funds for the Oregon Courthouse Capital Construction and Improvement Fund (OCCCIF). The report is to include, but not limited to:

- the legal sufficiency of the Clackamas County public-private partnership agreement(s), from the state's perspective, pertaining to funding agreement requirements;
- estimated total cost of ownership to construct, occupy, and maintain the Clackamas County Courthouse;
- affirmation of county ownership of the Clackamas County Courthouse building and property;

- a final master funding agreement; and
- a long-term flow-of-funds for state and local matching deposits into, and withdrawals from, the OCCCIF.

“The report may also include recommendations for statutory changes related to public-private partnership agreement(s) and the OCCCIF. The submission of this report is a prerequisite for the consideration of supplemental Other Funds expenditure limitation for the Clackamas County Courthouse project.”

Summary Responses

- 1) Legal Sufficiency of the P3 Agreement. Counsel for the state (the Department of Justice, or DOJ) and private counsel retained by the county agree that the P3 process meets constitutional and statutory requirements.
- 2) Estimated Total Project Cost. The total nominal cost to design, build, finance, operate, and maintain the new courthouse is estimated to be approximately \$420 million over a 30-year period. That estimate might change before the final project agreement is signed in the summer of 2022. The county is solely responsible for most of the project cost. The state and county share the planning, design, and construction cost for court space, co-located state agency office space, and common spaces. each is responsible for the fixtures, furnishings, and equipment (FF&E) for state and county occupied spaces, respectively. Once the building is complete and occupied, the county is responsible for all operations and maintenance costs.
- 3) County Ownership of the Property and Building. The updated Master Funding Agreement (MFA) that the state will sign with the county will require the county to own the project and project parcel at all times, and to keep the project and parcel free from any liens, security interests, or encumbrances.
- 4) Final Master Funding Agreement. The state is still negotiating the updated MFA with the county. We expect to have a final, signed MFA before the committee meets in January, 2022.
- 5) Long-Term Flow of Funds into the OCCCIF. The updated MFA also will require the county to deposit its matching funds into the OCCCIF, since the DOJ has opined that this is required under current state law. Other mechanisms are available to ensure the state is matching eligible expenses and the county is meeting its financial obligations if the legislature approves an alternative method.

Background

Before we provide more detailed responses to the questions in the budget note, we will provide the context and process for the public-private partnership (P3) project. In general terms, the county establishes a competitive process to have private entities with

specified qualifications submit designs and proposals for the new courthouse. The county will select the solution that provides the greatest value over the life of the asset for the amount paid. This process results in a P3 agreement – a binding and enforceable contract -- between the county and the selected private entity.

Signing the P3 agreement obligates the P3 partner to design-build-finance-operate-maintain (DBFOM) the new courthouse facility for an agreed-upon cost, and obligates the county to pay all costs under the agreement (notwithstanding any state financial contribution to the project). At all times, the county will own the building and the parcel. Once construction is complete and the building is accepted for occupancy (after meeting the contract standards) the county would make an agreed-upon completion 'milestone payment' and begin to make regular 'availability payments' to the P3 entity until the end of the term of the agreement. After the 30-year term of the agreement, the county would need to make new arrangements for operations and maintenance of the building. The P3 entity would not have any ownership or other interest in the building at any time.

The state would not be a party to the P3 agreement. Its interests are established and protected in the Master Funding Agreement (MFA) that OJD, the Department of Administrative Services (DAS), and the co-located state agencies sign with the county.

1) **Legal Sufficiency of the P3 Agreement:**

Both DOJ and private legal counsel contracted by the county have reviewed the P3 approach and concluded it meets constitutional and statutory requirements and is eligible for OCCIF funding under current law. Both legal memoranda are attached to this report as **Exhibit A** and **Exhibit B**.

The key documents in this process – the county's Request for Proposal (RFP) for P3 partners, the final P3 Project Agreement between the County and the Project Company, an updated MFA to reflect the P3 approach, and a funding agreement establishing conditions for use of the state bond proceeds – are still in draft form. OJD is reviewing the county's draft RFP and draft P3 Project Agreement and also is negotiating an updated MFA with the county.

OJD has not found any provisions of the draft RFP or P3 Project Agreement that conflict with the draft updated MFA or state legal requirements. The final updated MFA will be reviewed for legal sufficiency by legal counsel at OJD and DOJ, and OJD will continue to review the P3 Project Agreement as it is negotiated between the county and the P3 entity selected for the project. The current schedule anticipates a final P3 Project Agreement to be signed in the summer of 2022.

The county will be required to submit a proposed spending plan for the state bond proceeds to DAS before state bonds are sold. And will provide OJD with monthly design and construction progress reports. This will ensure that bond proceeds are used in accordance with OCCCIF requirements.

2) Estimated Total Cost of Ownership

The total cost of ownership will be established when the county signs a contract with the P3 entity selected for the project. That contract is expected to include a guaranteed maximum price for the project, including operation and maintenance costs, as well as a payment schedule. The county has developed an estimated cost of ownership that projects a total net cost - including operation, maintenance, and major lifecycle renewal costs – of approximately \$420 million in nominal dollars over the anticipated 30-year life of the agreement, of which approximately \$189 million is for design and construction costs incurred during the years 2022-2025, and eligible for the 50% OCCCIF contribution. **See, Exhibit C, Slide 3.** The current cost estimate includes escalation factors, however, if inflation continues to rise at current rates the project cost might change before the final P3 Project Agreement is signed in 2022. Currently, the state has obligated only \$94.5 million in state bond proceeds approved by the legislature based on the current cost estimate. If the final actual capital cost projection is higher, then the county and OJD will either have to reduce the project scope or request additional county and state funding which would require separate legislative approval.

In order to arrive at its decision to use a P3 delivery approach, the county in 2019 contracted with Rebel, a P3 Financial and Transactional Consulting firm to conduct an extensive Value-for-Money (VFM) analysis comparing the overall costs of five different project delivery approaches for the Clackamas courthouse project over a 30-year project lifecycle. The results showed that the P3 approach with 'Availability Payments' – contractual, all-inclusive payments that cover design, construction, financing, operation, and maintenance costs -- provided the best value-for-money to the county over the project lifecycle. Based on this analysis the Board of County Commissioners authorized the use of the P3 approach for the new courthouse.

OJD has not evaluated the total cost of ownership, since costs relating to operation and maintenance are county-only costs. The state's maximum contribution to the project would be limited by law to 50% of the cost relating to design and construction of the court portion of the new facility, the co-located state agency space, and shared or common space. In addition, Oregon law provides the state is responsible for the fixtures, furnishings, and equipment (FF&E) in the areas the court occupies in the courthouse. The state is not responsible for costs relating to building operations or maintenance, or for any costs of county offices in the courthouse.

In addition, OJD believes one particular advantage to the state of the P3 approach to this new facility is that the building would be operated and maintained by the P3 partner using contractual standards negotiated by the county with input from OJD. Under current law, while counties are responsible to provide “suitable and sufficient” court facilities, statutes do not establish specific standards as to how that obligation is met. As a result, counties provide different levels of service and maintenance, depending on local circumstances. Having specific contractual standards would mitigate that issue.

3) County Ownership of the Courthouse Building and Property

The draft updated MFA contains a representation, warranty, and covenant by the county that it will own the project and project parcel. The county already owns the property for the planned courthouse facility. The terms of the updated MFA will require the county to maintain ownership of the building and the project parcel at all times. In addition, the county would warrant that it will keep the building and parcel free from all liens, security interests, and other encumbrances.

4) Final Master Funding Agreement

OJD will execute a Master Funding Agreement (MFA) with the county and revise it if state funding is distributed to the county in phases (for example, if funds for planning and for construction are appropriated by the legislature in different biennia). The MFA outlines the key provisions of the OCCIF funding contribution to the county courthouse project. The MFA with Clackamas County has been supplemented by “Phase” agreements that contemplate distinct project phases, such as planning, procurement, design, construction and post-construction (if needed to close out items uncovered after occupancy).

The current MFA (for Phase 1) was executed to govern use of planning funds, before the county contemplated using the P3 approach. Phase 1 is now completed. Therefore, the county and the state are developing an updated MFA that recognizes the P3 approach, as well as a Phase 2 funding agreement to cover the procurement, design, and construction of the new courthouse. The county and the state are continuing to discuss the draft updated MFA and draft Phase 2 Agreement. We anticipate that the updated MFA will be completed and executed before the committee meets in January, 2022, and will provide a copy to the committee at that time. We expect the Phase 2 agreement to be completed in February.

5) Long-Term Flow of Funds Into and Out Of the OCCIF

In other state-supported courthouse projects – all of which have used traditional procurement methods - the MFA requires the county to deposit its matching funds into the OCCCIF, which then are quickly returned to the county. This process ensures that the county has matching funds available and that they are dedicated to the courthouse project. The matching state bond proceeds are then provided to the county on a reimbursement basis after ensuring the submitted costs are eligible for state match. The legislature provides expenditure limitation to OJD to allow expenditure of both the state bond proceeds and return of the county matching funds.

The P3 approach – and Clackamas County’s proposed use of state funds – allows consideration of a different approach. Instead of a ‘pay-as-you-go’ approach in which the county makes payments to the contractor(s) before the new courthouse is completed, the P3 approach makes the raising of capital and financing the project during construction the responsibility of the P3 partner. Payments by the county – using its own funds and transferred State bond proceeds – occur only upon completion and acceptance of the courthouse for use.

Accordingly, the OCCCIF is not anticipated to be used during construction to reimburse the builder as it would be during a traditional procurement. Instead, the county will enter into a P3 agreement where the Project Company will finance the design and construction costs and the county will begin making payments to the Project Company after the building’s occupancy readiness. It is anticipated that the state bond funds to the county will be used by the county primarily for a ‘milestone payment’ to the P3 partner at occupancy readiness to payoff a portion of the project debt. This is similar to how the state would pay during construction in a traditional procurement, except the state will not have to pay until the building is complete and deemed acceptable. The county’s payments to the P3 partner will be made over the next 30 years to payoff the remainder of the project debt (capital charge) and for the Project Company performing operations and maintenance duties. The capital charge portion of the availability payment is similar to the debt service payments that would be made on municipal bonds during a traditional procurement.

Modifications to the OCCCIF statutes would make them more conducive to P3 structures. However Clackamas County has agreed to deposit the *capital portion* of its availability payments into the OCCCIF and then withdraw them to make the availability payment to the Project Company, to comply with the current statute language. This is comparable to depositing municipal bond payments into the OCCCIF before withdrawing them to pay the bondholders over the term of the bonds, something that is not required in a traditional approach. This process is also described in **Exhibit C, slide 7**.

We discuss this topic again in the Other Information portion of this report, below.

6) Affirmation of County Ownership

Clackamas County confirmed that it would retain ownership of the new courthouse in a P3 structure before pursuing this approach, a critical requirement for the use of state bond funds for design and construction, as addressed in the draft P3 agreement (**Exhibit D**), section 25.1 Ownership: “The Project shall be owned by the county all times.” Similarly, the county will make an identical representation to the state in the updated MFA.

The final P3 agreement will make clear that the P3 partner will not have any ownership interest in the completed courthouse. The P3 partner’s financing of the design and construction of the courthouse will rely on the county’s promise to pay the ‘availability payments’ as outlined in the P3 agreement to be executed between the P3 partner and the county.

Other Information

A. Recommendations for Statutory Changes

The county’s retained counsel has proposed amendments to the current OCCCIF statutes, set forth in **Exhibit E**. The sole intended purpose of the proposed amendments would be to remove the need, as identified in the DOJ memorandum of law (Exhibit A), for the county to cycle its monthly capital contribution payments into the OCCCIF before the payment is made to the P3 partner. (Again, the payments would be made only after the new courthouse has been accepted for occupancy.) The county believes the State has minimal interest in receiving and then immediately disbursing funds back to the county once the completion risk of the Project has been eliminated.

OJD agrees that the primary purpose of requiring the county to deposit its matching funds into the OCCCIF is to ensure that the county has sufficient matching funds, dedicated to the project and eligible for state match before the state releases its bond proceeds. Under Clackamas County’s P3 approach (using the state proceeds for the milestone payment when the courthouse opens and then making its availability payments over time) OJD will use the updated MFA to require regular reports on project expenditures to verify that costs and expenditures during construction are eligible for state match. Because most of the county’s expenditures come after a milestone payment at project completion and acceptance, the main purpose of continuing to require county deposits is to track that the county is, in fact, making those availability payments. It is possible to use the other methods to achieve that goal (e.g., use the MFA to require written notice if the county fails to make a payment). We leave it to the legislature to decide the best mechanism to achieve that goal.

Neither OJD nor the county see an immediate need to modify the OCCIF statutes to address these issues but wanted to call the process to the attention of the legislature for its consideration.

B. Application of Prevailing Wage Laws

During the Capital Construction Subcommittee hearings during the regular session, the question arose whether workers on the courthouse project would be paid prevailing wage. The county confirms that the courthouse project is a public works project and prevailing wage laws will apply.

Summary:

We trust these responses to the budget note have explained the county's due diligence process and decision to pursue a P3 delivery approach. The county has engaged OJD throughout this process to ensure a P3 delivery approach is acceptable to the OJD, is a legal procurement approach and that it qualifies for OCCIF funding. The county and OJD request that the Committee acknowledge receipt of this report and recommend to the 81st Legislative Assembly that the OJD Other Funds expenditure limitation for the 2021-23 biennium be increased by \$94,499,999 to allow sale of the state Article XI-Q bonds to support a new, safe Clackamas County Courthouse.

Sincerely,

Nancy J. Cozine
State Court Administrator

cc: Sen. Betsy Johnson
Martha Walters, Chief Justice
Tootie Smith, Clackamas County Board of Commissioners Chair
Gary Schmidt, Clackamas County Administrator,
Gary Barth, Clackamas County Courthouse Project Manager
Laurie Byerly, Legislative Fiscal Officer
Phillip Lemman, Deputy State Court Administrator
David Moon, Director, OJD Business and Fiscal Services Division

Exhibits:

- A – DOJ legal memorandum, May 20, 2021
- B – Hawkins, Delafield legal memorandum, October 4, 2019
- C – Presentation to Clackamas County Commission, August 24, 2021
- D – Draft **P3 Partner Agreement** Term Sheet
- E – Proposed amendments to OCCCIF statutes, 8/6/21

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