

I. Introduction

This White Paper presents an overview on the options available to the District of Columbia Public Schools (“DCPS”) to increase the funds it has available to support the modernization and renovation of school facilities. Like many other urban public school districts throughout the nation, DCPS faces a critical need to increase the amount of funding it has available to maintain and rehabilitate its portfolio of aging real property. The paper discusses the general status and sources of DCPS’s capital funding allocation, and discusses an approach and recommendations to solving the challenge of increasing the amount of funding available. The paper also addresses the key issues and challenges associated with implementing the recommendations. This paper was written by Winbourne & Costas, Inc. of Washington, DC.

II. Expanding Resources

While the capital needs of DCPS has been great, the system historically has had access to only a very limited amount of funds from the District’s capital budget. The District’s capital budget for 2003 was approximately \$170 million, and is expected to remain at that level into the foreseeable future. Currently, DCPS’s only major reoccurring source of capital funds is an annual allocation from the District of Columbia’s annual capital budget, derived from the issuance of general obligation bonds. The vast majority of DCPS’s capital financing comes from the District’s general obligation bond sale, which is supported by the city’s general fund revenues.

In contrast, many other local jurisdictions have their own taxing authority, and can issue bonds directly for capital improvements. DCPS, unlike most other local school districts, has no independent revenue source, taxing authority, or regular access to other sources of capital for maintenance improvements or new construction. DCPS must therefore rely solely on the District government to ration scarce capital dollars to fund school repair and construction.

Table 1 - Summary of Local School District Governance and Taxing Authority

<i>School District</i>	<i>Part of City Government</i>	<i>Independent Taxing Authority</i>	<i>Issue Bonds</i>
New Orleans	No	Yes	Yes
Seattle	No	Yes	Yes
Chicago	No	Yes	Yes
Philadelphia	No	Yes	Yes
San Diego	No	No	No
Duval County	No	Yes	Yes
Baltimore	Yes	No	No
<i>DCPS</i>	<i>Yes</i>	<i>No</i>	<i>No</i>

Also, unlike most other school districts, DCPS has no state government to provide some or all of the funds necessary to perform capital repairs. A majority of state governments provide some form of assistance to local school districts for maintenance, repair, and construction activities. The forms of state assistance to local school districts ranges from direct payments to fund qualified activities, to providing matching funds to offset the costs of new construction, and range in many cases from 50 to 75 percent of total costs of approved construction projects.

Table 2: Summary of State Government Financing

<i>State</i>	<i>Majority of Funding Local</i>	<i>Revenue Supporting Bonds</i>	<i>Local Match</i>
Florida	Yes	Utility tax, license tag fees	Project orientated
Georgia	Yes	Lottery, sales tax, general fund, property taxes	Varies between 10% - 25 % (based on wealth of district)
Massachusetts	Yes	Property tax, sales tax	Between 10% - 50%
Washington State	Yes	State timber sales	Project orientated
<i>District of Columbia</i>	<i>Yes</i>	<i>General fund revenue obligations</i>	<i>N/A</i>

DCPS’s main source of capital funds, the District’s annual bond issue, is itself severely curtailed by resources available in the operating budget to pay debt service; the debt ceiling cap of 14 percent of anticipated revenues; and the District’s limited authority to issue alternative types of debt instruments.

III. Changing Paradigms

Any increase in DCPS’s traditional bond financed capital allocation will most likely come from either non-traditional revenue, or other sources - for example Congress, or at the expense of other District agencies capital budgets, or alternatively, the result of an increase in tax revenues to support an increase in the annual bond issue. Given the District’s extremely high rates of property, and projections of large and growing federal budget deficits, it is unlikely that DCPS will be able to obtain more funds from either of these sources.

DCPS’s interest in reviewing and exploring alternative sources of funding to support its capital program, despite these limitations in its traditional funding sources, provides an exciting and challenging opportunity to move away from the **facilities management** perspective of ownership. That is, real property is a tool, supported by tax income and expenses, and within whose activities require direct appropriations to support. As such, it must be managed to minimize expenses. A facilities management approach to property promotes a warehousing mindset, whereby the value of property is in housing a specific

function, and so investments into the property are sunk costs. It promotes a primarily custodial view of the public's ownership.

An **asset management** perspective is a more entrepreneurial view of property. It says that the public real estate holdings are assets as well as tools. Not only should the public

The Asset Management perspective is entrepreneurial. It believes that public real estate holdings are assets as well as tools.

owner get the most use out of its assets, but they should also seek to derive the most value. The value in managing from an asset management perspective is that the public owner is constantly determining how to restructure and reposition the things it owns to create the things that it needs – in DCPS's case, a stable income stream to support new construction, or new or renovated facilities.

From an asset management perspective, potentially all buildings and properties within

DCPS's portfolio are performing assets. They can generate income to fund improvements, renovations, and new capital development.

To implement a successful asset management initiative, of the scale envisioned by DCPS, our experience indicates there are a couple of key values or features which we think DCPS must understand, embrace and weave into every aspect of the approach. These feature will be intrinsic and essential to the approach we outline in our proposed program.

1. It is Usually More About Consensus Than the Solution: Where public assets are involved their successful repositioning usually involves a wide diversity of constituencies. From DCPS stakeholders to community leaders, from elected officials to neighbors, from environmentalists to transportation advocates. Each property will have a broad range of constituencies vested in the future of that asset. The value to be derived, by the public owner, is often a function of the quality of the process employed to create consensus.

2. Public-Private Partnerships are the Most Effective Tools for Creating the Greatest Public Value: When public owners are attempting to generate value from public assets their objective will be best met by partnering with those who have the most successful record of creating value. This involves a move from the typical "us-them" contracting paradigm to a more flexible partnering relationship driven by common objectives.

3. Objectives Must be Incentive Based: Compensation in public contracting tends to be effort based. That is, contracting is often based on a statement or scope of "work". Work is paid for on a unit or work, like hourly, basis. Sometimes, work may be paid for on a deliverable basis. The most successful compensation structures in the asset management and development arena are based on incentives. That is, incentive compensation plans aligned with the objectives of the owner.

4. Approaches and Solutions Must be Dynamic: There will always be better ideas and new constituencies. Work products should be kept in “draft” form as long as possible so they can incorporate constant improvement.

5. Owners Must be Represented Throughout the Process. Owners partnering with developers and/or asset managers to reposition properties need to supplement their public team with the same kind of market-based representation on their side of the table throughout a transaction as the developer and/or asset manager has on their side of the table.

IV. Creating Value

To the public owner, properties usefulness is typically in the past or present, and its value is determined by a sale price. To the developer and local community, the property’s future vision is what is important, and its value must be created through enlightened leadership. The approach we outline is based on creating a consensus solution that causes the property to be repositioned to meet the mutual objectives of its public owner and its community. A community that actively participates in defining the future of the property is a community that will be comfortable in zoning the property to its highest practical use. That is an outcome that will also achieve the highest return to its current owner.

Our proposed approach is as follows:

- 1. Initial Meeting and In House Data Collection.** Meet with DCPS staff to determine the extent and quality of data available on properties. Discuss with various DCPS stakeholders the work already undertaken and get a better understanding of DCPS’s specific objectives. Get a “lessons learned” perspective of other successful and unsuccessful initiatives. Identify the various community constituencies and stakeholders that will be involved in this process; identify their interests and experience.
- 2. Preliminary Review of Properties.** Visit the various properties and get a preliminary view of the range of assets. Meet with current occupants to get a local view of individual factors.
- 3. Community Charette:** Organize a preliminary meeting with community groups and other stakeholders to listen to what they realtors, surrounding land owners, and other interested parties have to suggest. Work together with them to come to an understanding about potential projects, what their goals and limitations are, and how these might fit with your ideas. Since achieving consensus is critical to this process, this will be the first of a multitude of meeting with community groups and the developer (once one is selected) to create a final vision and plan for the site.

4. **Draft a Detailed Implementation Strategy.** The strategy will be a more detailed schematic for proceeding with the project. It will be an expansion and refinement of the values and approach outlined in this proposal. The strategy will be drafted so as to define the consensus-based **process** for creating and implementing solutions rather than identifying specific solutions. The strategy will be kept in draft form so as to communicate flexibility as additional constituencies are engaged in the process.
5. **Feasibility Studies.** We will undertake feasibility studies of the properties identified by DCPS. The primary purpose of the feasibility studies will be to:
 - a. **Identify Likely Uses.** The feasibility studies will identify the most likely market opportunities represented by each property.
 - b. **Create a Working “Balance Sheet”.** Derive an estimate of the market potential represented by the various properties. This is the first real test of the likely product of the effort.
 - c. **Identify Constituencies.** Further identify the individual constituencies likely to be affected by or otherwise be interested in any change in the current use of DCPS’s properties.
 - d. **Identify Synergies Between Properties.** Identify those properties with likely similar uses that might be bundled for incorporation in a single solicitation.
6. **Review/Revise Strategy.** Based on the results of the feasibility studies the strategy should be refined in consultation with DCPS to reflect the results.
7. **Issue Draft Solicitations.** The form of solicitation that should be employed is Requests for Qualifications (RFQ). The RFQ should identify the nature of the private partner sought by DCPS. That partner generally should be a developer or asset manager with a prior record of creating value in relationships. The RFQ would be designed to DCPS procurement standards and present the following material:
 - a. Identify the kind of partner sought.
 - b. Identify the objectives of the owner.
 - c. Outline the results of the feasibility study. The results should be identified as the apparent highest uses, but should not limit consideration of other ideas.
 - d. Identify the business planning and redevelopment process outlined below.
 - e. Present the evaluation criteria.
 - f. Outline DCPS’s compensation objectives and request the offeror’s compensation expectations and prior compensation experience.

- 8. Conduct an Industry Conference.** The draft solicitation should be used as the form of invitation to the industry to attend a conference to discuss the opportunities and process.
- 9. Reissue the RFQs.** After incorporating whatever changes are agreed to from the Industry Conference, DCPS should reissue the RFQs requesting responses in about 30 days. Responses can be prepared in such a short time frame because the response is not focused on **what** the private partner will do but rather **who** they are and what they have accomplished. There is no need to assemble a development team or propose detailed business terms. Those things will come later in the process of creating consensus and negotiating terms. An additional advantage of an RFQ is it significantly reduces the pursuit costs for offerors. That has the effect of expanding competition. Moreover, RFQs are the preferred vehicle for the best quality developers and asset managers thereby helping DCPS to access the talent necessary to create the most value.
- 10. Finalize Source Selection Process.** While finalizing the solicitation(s) we will also complete the source selection plans. This will include the selection of source selection officials and briefings in the criteria and process to be employed. In considering the composition of the source selection process DCPS should consider the involvement of local constituencies. We have facilitated public procurements where local constituency representatives have been active participants in the review of responses and the source selection process. This can be a challenge for public procurement regimes but an enormously powerful tool in facilitating local buy-in.
- 11. Evaluation of Offers.** This will be the process for reviewing responses, interviewing and examining references. Also, during this time we should be examining the structure of the offerors other deals and relationships.
- 12. Selection.** As a result of the selection process DCPS will choose a prospective partner for each property or aggregation of properties. “Prospective” because the selection should be contingent upon successfully completing the business planning process and negotiating an implementation structure.
- 13. The Business Plan.** For each property the selected developer working with DCPS and the constituencies associated with each asset will create a business plan. The business plan will be the product of the developer’s and DCPS’s joint due diligence completed in consultation with the project’s constituencies. The purpose of the plan is to create a consensus around an approach to repositioning each asset that gets the best return for DCPS and is agreeable to the local community on business terms acceptable to DCPS’s private partner.

The planning process must be “open book” in order to achieve the buy-in and consensus necessary to proceed. Typically the business plan includes:

- a. The specific concept for repositioning the asset,
- b. The pro formas for the financing and operation of the project,
- c. The business terms between the developer and DCPS for implementing the plan.
- d. The anticipated return to DCPS from the repositioned asset,
- e. The acquisition strategy for putting in place the necessary development,
- f. The environmental and other considerations that must be resolved to proceed with implementation, and
- g. Any additional authorizations necessary to effect the implementation of the plan.

In order to create the plan the selected developer may have to engage additional team members like architects, land planners, traffic consultants, retail experts, environmental specialists or the like. These additional participants are typically selected as the result of a competitive process conducted by the developer subject to the owner’s oversight. Like the developer the understanding during the business planning process is that parties contributing to the plan will have the relevant role during the implementation process. Therein lies a strong incentive to help craft a plan that works for the owner and the community as well as each prospective contractor or subcontractor.

14. Authorization. Depending on the nature of the transaction a wide range of authorizing actions may be required. These could range from zoning and permitting actions to enabling District or federal legislation.

15. Transaction Documentation. The business terms outlined in the business plan must be embodied in transaction documents. The documentation may involve leases, sales agreements, development contracts, land leases, management contracts and a wide range of additional instruments. Final details must be negotiated, transactions structured, financed and closed.

16. Implementation. DCPS will be represented during implementation of the plan which may involve design and construction activities and a host of other operations. The level of involvement will vary depending on DCPS’s participation in the project and its return.

V. How to Contact US

For further information regarding issues discussed in this white paper, please contact:

Winbourne & Costas, Inc.

Andrew G. Reece

Vice President

1411 K Street, NW Suite 1200

Washington, DC 20005

Telephone (202) 737-6001, Extension 204

Facsimile (202) 737-6003

areece@winbournecostas.com