

LEASE-LEASEBACK: WHAT'S ALL THE FUSS?

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A. What is Lease-Leaseback — Per Education Code Section 17406¹

The Lease-Leaseback (LLB) method for delivery of a construction project follows the loosely-defined process of Education Code section 17406, and involves selecting a builder, sometimes referred to as a "Developer-Contractor," to build, and sometimes design and build, either a new building or modernization of existing buildings, and always on property owned by the District. The builder simultaneously executes a Site Lease of the property, giving the builder the right to develop the project, and a Facilities Lease, giving the builder the obligation to design and/or build the project, and to lease the improved property back to the District.

In the end, at the expiration of the Lease, the District will own the improvements, following payment of the agreed price for the work. There are several different approaches to the concept, with some districts doing only the construction, others doing both design and construction. The form of the arrangement governs when the builder is retained. Where only construction is sought, the builder may be under separate contract to provide constructability support throughout the design, then is contracted to provide the construction, for a guaranteed maximum price. The duration of payments may depend on whether the district is using this method for financing of the project.

One thing has become clear, and that is the acceptance of this method of project delivery, without bidding, by the State, who will fund the project similarly to funding for other styles of project delivery. The preconstruction work by the builder may be done under separate agreement, or under an agreement that is amended to add other obligations relating to the construction. The guaranteed maximum price is negotiated, and all other rules applicable to public works projects, such as prevailing wages, bonding, insurance, and the other Labor Code matters, apply to this project delivery method.

¹ 17406. (a) Notwithstanding Section 17417, the governing board of a school district, **without advertising for bids**, may let, for a minimum rental of one dollar (\$1) a year, to any person, firm, or corporation any real property that belongs to the district if the instrument by which such property is let requires the lessee therein **to construct on the demised premises, or provide for the construction thereon of, a building or buildings for the use of the school district during the term thereof, and provides that title to that building shall vest in the school district at the expiration of that term**. The instrument may provide for the means or methods by which that title shall vest in the school district prior to the expiration of that term, and shall contain such other terms and conditions as the governing board may deem to be in the best interest of the school district.

(b) Any rental of property that complies with subdivision (a) shall be deemed to have thereby required the payment of adequate consideration for purposes of Section 6 of Article XVI of the California Constitution.

B. What Are the Advantages?

1. No Bidding: The SAB and OPSC now accept that the LLB method may be performed without bidding, but does still require DSA approval of the design documents. Subcontractors need not be competitively selected, either.
2. “Choosing” your partners in the project creates a “team” approach, or at least it can, if everyone acts with the interests of the team in mind.
3. Quicker, although we’ve seen no data demonstrating the magnitude of any time savings.
4. Satisfies the need for project “financing” if required, as payments can stretch out for years beyond the completion of the project, if necessary, with interest accruing, of course.
5. Permits participation in subcontractor selection as well, although it is neither mandated nor prohibited.
6. Solicitation of cost saving ideas from trade contractors and suppliers, as part of their selection process, can help meet budgets. The emphasis is on “can” and someone needs to watch that “quality” doesn’t suffer.
7. Developer-Contractors can set Guaranteed Maximum price very early in a project. There is no guarantee the price will be lower.

C. What Are the Disadvantages/Pitfalls?

1. There have been concerns by OPSC staff and State Allocation Board members that the flexibility of the lease leaseback statutes could lead to faulty practices. The absence of guidance, and reliance on individual legal counsel to provide the structure for the deal could result in errors, at the least. Favoritism is also a risk.
2. Questions exist regarding whether leases can be signed prior to DSA stamp out of plans. Certainly, construction cannot begin, and the possibility of DSA changes could affect the price, if already set.
3. Lease leaseback is new and not as well understood by the design and construction community.

D. What Controversy?

We anticipate that this method of project delivery will become more common as State funding dries up. We also anticipate the possibility of “horror stories” becoming the catalyst for legislation to either regulate, or eliminate, the process. As with the concept of “piggybacks” the LLB process could become fertile ground for abuses, with builders going

further and further from the traditional rules of construction projects, thereby drawing the attention of parties with interests in school construction, such as unions. Since contracts are negotiated, some believe unions will have more difficulty competing for the work.