

Lease-Leaseback Project Delivery (With “New” Prequalification)

San Leandro Unified School District
February 4, 2014

Phil Henderson
Orbach Huff Suarez & Henderson LLP

© 2014 Orbach Huff Suarez & Henderson LLP



California School District Procurement Generally

- ❑ **Bid Limits.** California school districts must formally and publicly bid contracts for construction projects over \$15,000 (Public Contract Code § 20111), unless there is an exception.
 - Different bid limits under CUPCCAA.

© 2014 Orbach Huff Suarez & Henderson LLP



Exceptions to Public Bidding (Some, not all)

- **Emergency Contracts**
 - Public Contract Code §§ 1102, 20113
- **Energy Efficiency Contracts**
 - Government Code § 4217.10 et seq.
- **Multiple Award Contracts**
 - CMAS, CalNET, PSS, U.S. Communities
- **Piggyback Contracts**
 - Public Contract Code § 20118
- **Design-Build Contracts**
 - Education Code § 17250.10 et seq.
- **CM At-Risk Contracts**
 - Generally prohibited by *City of Inglewood-L.A. Civic Center Authority v. Superior Court* (1972) 7 Cal.3d 861.

© 2014 Orbach Huff Suarez & Henderson LLP



The Lease-Leaseback Exception

- Lease-leaseback (“LLB”) is an exception that was enacted at a time when there was a shortage of money for school construction. Therefore, financing has historically been part of the arrangement, but not used much anymore (Education Code § 17406 (a)):
 - “Notwithstanding Section 17417... a school district, without advertising for bids, may let ... real property that belongs to the district if the [lease] requires the lessee ... to construct ... a building or buildings for the use of the school district.”

© 2014 Orbach Huff Suarez & Henderson LLP



LLB – Basic Structure

- ❑ District leases real property to a builder for \$1. (**Site Lease**)
- ❑ Builder constructs facility, then leases the facility back to the district. This is the “leaseback” component. (**Facility Lease**)
- ❑ District payments for construction costs:
 - **Tenant improvement payments** during construction.
 - **Lease payments** after construction.
- ❑ The construction terms and conditions are part of an exhibit to the Facility Lease (e.g., Ex. D “**General Construction Provisions**”).
- ❑ Title to the new facility vests in the District as lease payments are made.
- ❑ District makes lease payments for period of time and then has the option to make a balloon payment to builder to buy out the facilities lease.

© 2014 Orbach Huff Suarez & Henderson LLP



LLB – Recommended Procurement Method

- ❑ **Architect.** First, owner selects architect through RFQ/RFP, to design project.
- ❑ **Builder.** District selects builder through RFQ/RFP process.
 - **Highly recommended.**
 - Criteria should include experience, qualifications, and pricing (e.g., general conditions, fee, OH&P, etc.).
 - Should require soliciting trade contract (subcontract) prices from a minimum number of subcontractors for each scope.
- ❑ **Optional (but recommended):**
 - **PSA.** Owner enters into preliminary services agreement with builder.
 - ❑ Depends on status of design, etc.
 - ❑ Builder has had an opportunity to provide input into this design.
- ❑ **DSA.** Architect completes design and gets DSA approval.

© 2014 Orbach Huff Suarez & Henderson LLP



New Prequalification Law LLB – Recommended Procurement Method

- **New Law (PCC § 20111.6 per AB 1565).**
 - **Mandatory:** (b) .. [D]istrict shall require ... each prospective bidder ... submit ...a standardized questionnaire and financial statement ... [“[Prequal Forms]”].
 - **\$1m State-Funded Projects:** (a) [P]ublic projects, [using state funds] ... that involves a projected expenditure ... \$1,000,000 or more ...
 - **GC and MEP Subs:** (i) ... “[B]idders” shall include the general contractor and, if utilized, all electrical, mechanical, and plumbing [“[MEP]”] subcontractors.
- **Does PCC § 20111.6 apply to LLB contracts?**
 - Arguably, “No.” But, safest option:
 - **Include a prequalification form with your RFQ/RFP. But it takes some coordination.**

© 2014 Orbach Huff Suarez & Henderson LLP



New Prequal. Law (cont'd.) LLB – Recommended Procurement Method

1. **RFQ.** District distributes the LLB RFQ, which will include the prequalification form for the respondents (the “general contractor”) only -- not the trade contractors (subcontractors) yet.
2. **RFP to Small Pool.** The District will select a small pool of firms from the initial RFQ respondents.
 - The District will send an RFP to that small pool of firms (“You have been selected to go to the next round, etc.”).
 - This RFP will include the prequalification questionnaire for all mechanical, electrical, and plumbing (MEP) trade contractors.
 - This RFP will also direct that small pool of firms to immediately provide the prequalification questionnaire to all of its potential MEP trade contractors.

© 2014 Orbach Huff Suarez & Henderson LLP



New Prequal. Law (cont'd.) LLB – Recommended Procurement Method

3. **MEP Trade Contractors.** All of these potential MEP trade contractors must submit their completed prequalification questionnaires to the District within a very short time frame.
4. **MEP List.** The District will do its evaluation and then provide a complete list of all prequalified MEP trade contractors to that small pool of firms.
5. **RFP Responses.** Once that list of prequalified MEP trade contractors goes out to that small pool of firms, the District will give that small pool of firms at least a few weeks to respond to the RFP, depending on the complexity of pricing the project, etc.

© 2014 Orbach Huff Suarez & Henderson LLP



LLB Contracts Are Still School District Public Works Contracts

- ❑ **Builder Must Pay Prevailing Wages.** (Ed. Code §17424)
- ❑ **Payment Bond Required**
 - Civil Code § 3247: “Every original contractor to whom is awarded a contract by a public entity . . . in excess . . . of \$25,000 for any public work shall file a payment bond.”
 - Get a performance bond too.
- ❑ **DSA Approval Required.** Site must be approved and design documents must be adopted before entering into agreements. (Ed. Code §17402)
- ❑ **Field Act Compliance Required.** Construction is subject to all State approvals, as set forth in Education Code sections 17280 through 17313. (Ed. Code §17421)

© 2014 Orbach Huff Suarez & Henderson LLP



LLB Provisions That Should Be Considered

- **Funding.** Due to available funding, most districts have the construction funds for their project. Those districts make tenant improvement payments during construction.
 - In those instances, critics have asserted that the lease is, in fact, a conventional construction agreement.
 - But, Section 17406 does not state that the District's payments be financed or that payment be deferred until the project is completed.
- **Buy Out.** Districts must consider how quickly it can buy-out the lease.
 - A 6-month required occupancy prior to a buy-out option is more commercially typical than a buy-out option on the first day of the school district's occupancy.
 - Districts have approved buy-out options at the time a "final payment" would be due under a standard construction contract (i.e., after 35 days and before 60 days after a notice of completion.)

© 2014 Orbach Huff Suarez & Henderson LLP



Recent Challenges to LLBs

- Usually arise in response to District filing a "validation action."
 - Some of the cases have been "reverse" validation actions where an entity sues the school district.
- Recent Cases:
 - *Solana Beach SD v. All Persons* (District won case)
 - *Sweetwater Union SD v. All Persons* (District won case; no likely appeal)
 - *Davis v. Fresno USD* (District demurrer sustained; likely appeal)
 - *McGee v. Torrance USD* (District demurrer sustained; likely appeal)
 - *Long Beach USD v. All Persons* (Case is ongoing)
 - *Los Alamitos USD v. All Persons* (District won summary judgment; likely appeal)
- Allegations include:
 - Application of Educ. Code sec. 17417 process.
 - Failure to comply with Educ. Code sec. 17423 requirements.
 - Need to finance.
 - Conflict of interest, presumably based on PSA.
 - Failure to formally bid pursuant to Public Contract Code sec. 20111.

© 2014 Orbach Huff Suarez & Henderson LLP



Repeated comment from attorney handling these cases to newspaper articles:

"I am the construction attorney referenced in this article. Are you a taxpayer in a school district other than Solana Beach that does lease-leaseback? Are you a contractor that has been shut out of school construction work because you are not on the 'in' with the small cartel of general contractors that have a lock on school district lease leaseback contracts statewide?

If so, I would be willing to discuss representing you AT NO COST TO YOU in a lawsuit challenging no bid lease-leaseback construction contracts in your school district. I genuinely believe the way lease leaseback school contracting is being done does not comply with California law and must be stopped. The current method of lease leaseback contracting has gone on for as long as it has because taxpayers are not aware of their legal right to challenge these contracts and/or no taxpayer has been willing to pay an attorney to fight this fight.

I AM WILLING TO FIGHT THIS FOR FREE for a few select taxpayers and contractors. Please email me at info@carlinlawgroup.com if you would like to discuss this further. Keep in mind there is only a short window of time after each leaseback contract is awarded in which taxpayers can challenge them in Court. The State Bar of California requires I advise you that this is a solicitation for legal services notwithstanding the fact I am offering to do this for free."

Is LLB Better? Cheaper? Faster?

❑ Cost

- Potential cost reduction through RFQ/RFP process, subcontractor price, value engineering, fewer performance issues, etc.
- Potential cost increase compared to formal design-bid-build because the builder has less incentive to reduce fee or overhead/profit amount if these costs are not formally bid.
- **LLB is not designed as a cost saving tool, but Districts can level the cost impact by adding competition.**
 - ❑ District should select builder through RFQ/RFP, which can include qualifications and pricing criteria.
 - ❑ Builder should be required to use the lowest bid for each trade contract (subcontract), unless it can show to the District's satisfaction why it wishes to choose the next lowest bidder.

Is LLB Better? Cheaper? Faster?

- **Price Evaluation.** District, architect and builder should always thoroughly walk through the plans as a group, with builder's price, to ensure all parties fully understand the scope, schedule, etc.
 - If there are any items missing or over-priced, they are addressed prior to the parties approving and signing the LLB contract.
- **Responsibility.** Builder takes on more responsibility and therefore is more motivated to manage costs.
 - Especially if builder performs detailed constructability review before pricing.
 - LLB contracts may carry a contingency amount that the District can use as a cap on any portions of work the builder missed in its pricing.
 - Builder does not take on direct liability for design errors—that remains with the architect.
 - Anecdotally:
 - Most LLB projects are completed timely, with few change orders and delay claims.

© 2014 Orbach Huff Suarez & Henderson LLP



Prudent Steps

- Construction cost should be comparable to cost if it had been competitively bid to a low bidder.
- Structure agreement so that it is a defensible lease structure.
- Pick a builder:
 - That has a solid track record of timely completion.
 - If possible, that the District has (good) experience with.
 - (Maybe) that has completed previous LLB projects.
- District could consider filing a validation action after Board approves a LLB contract.
 - Most Districts do not do this anymore.
 - See earlier slide on challenges to recent LLB contracts.

© 2014 Orbach Huff Suarez & Henderson LLP



Lease-Leaseback Project Delivery (With “New” Prequalification)

Thank You

Phil Henderson

phenderson@ohslegal.com

510.379.4091

Orbach Huff Suarez & Henderson LLP