

# Leveraging Models: The 63-20 Process

Participation in the 63-20 bonding process offers ample incentives for developers.

**The National Development Council (NDC), a New York City–based nonprofit organization that has overseen a number of 63-20 projects in Washington State, issued \$189.7 million in 63-20 bonds for the Ninth and Jefferson Building at Harborview Medical Center. NDC is the owner of the medical office building; NDC’s use of the 63-20 process helped Harborview erase a \$30 million project overrun on the previous process.**

IF JOHN LENNON’S song “Imagine,” the wistful plea for a world that works properly, were expanded to the construction of public facilities and infrastructure, the following are some of the elements such a song would likely include:

- ▷ Imagine a private developer building a city hall with the same attention to quality, cost, and timing as if it were to be owned and held in the developer’s own portfolio, and then turning it over to the city at no cost.
- ▷ Imagine a government capital planning and development agency opting out of the cumbersome and contentious design-bid-build approach and establishing “best value” instead of “low bid” as its primary goal—one where the best value turns out to be less expensive than the low bid.
- ▷ Imagine a municipal or state government simply requesting an office building of specific dimensions at a specified location and a specific price, and then sitting back

waiting to move in—with the construction process posing no risk, financial or otherwise, to taxpayers or political officeholders.

There are those who have used the 63-20 bonding process—a 1963 Internal Revenue Service (IRS) revenue ruling—to build public facilities who would insist that that is actually the way it happens. In Washington State, for example, where over the past decade close to 20 public projects have been completed using this process, savings are reported to have ranged from 15 to almost 50 percent.

“Fifteen years ago, the 63-20 process got on my radar,” recalls Jim Napolitano, at the time the major projects manager for King County, Washington’s capital planning and development agency. Frustrated with the public building process, Napolitano says he saw 63-20 as a way to introduce efficiency and lower costs and, at the same time, eliminate risk for taxpayers.

“It gets you out of the public works arena and into the private real estate arena,” Napolitano explains. “That’s the beauty of it. You are using [private developers] to build public buildings. They do this for a living and have to be efficient at it.”

With the design-bid-build process, he says, cost overruns are regular occurrences and public agencies and general contractors are almost always at odds. The 63-20 process changes the dynamic. “First and foremost, it’s safe,” insists Napolitano, who retired from county government after 30 years and is now major projects manager for Harborview Hospital and the University of Washington. “It eliminates risk for government where projects routinely go over budget. Not one 63-20 project ever cost the government money,” he points out. “How much would you pay for a Lloyds of London insurance policy for that?”

When issued in 1963, the 63-20 ruling was the first attempt to make tax-exempt financing available for nonprofit institutions. Hospitals were the original target, but the ruling applies to a wide range of government projects, from transportation to student housing. The process includes three parties: a government agency with a specific project requirement, such as an office building it intends to occupy; a nonprofit agency that will issue the tax-exempt bonds, oversee the financing and construction processes, and later manage the facility; and the developer, who for a guaranteed maximum price (GMP), builds the facility within an established time frame.

The 63-20 process envisions the nonprofit agency as the project’s facilitator, communicating requirements of both the government agency and the developer until agreement is reached and contracts are signed. The nonprofit issues tax-exempt bonds and legally owns the facility until the debt is retired, at which point ownership reverts to the government at no cost or a nominal fee.

The selection of the nonprofit organization and the developer is critical to success. The nonprofit, explains John Finke, director of the National Development Council (NDC), a New York City–based nonprofit organization that has overseen close to 20 63-20 projects in Washington State, must understand real estate and the construction process. “There should be qualities about the [nonprofit] that suggest it will be in existence for the next 30 years, or the length of the bond term. It must understand real estate development and long-term asset management—and it must understand bond compliance.”

Founded in 1969, the NDC is one of the oldest community and economic development corporations



in the country. Its primary focus is helping governments use public financing tools to spur investment in urban areas. Although the NDC has a national reach, the vast majority of the 63-20 projects it has been involved with have been in the Northwest. Very few have been on the East Coast, which Finke suggests may be due to tougher public construction regulations in eastern states.

Other factors that may have inhibited its use include the mandate to return facilities to public ownership at no cost—or a simple lack of exposure may be to blame. For decades, the 63-20 process was virtually forgotten. Subsequent IRS rulings that allowed conduit issuance of tax-exempt debt for 501(c)(3) corporations without the mandate to return the property to government ownership became the vehicle of choice.

The motives for using the 63-20 process for government agencies and dedicated nonprofit organizations are straightforward: governments get a high-quality product at a guaranteed price and nonprofit organizations fulfill their mission of facilitating economic development. But what is the incentive for developers?

Developers have no ownership stake in the project, they work for a set fee, and they assume the financial risk associated with guarantee-

ing completion at a specified time. Cindy Eden, senior vice president and director of development at Seattle-based developer Wright-Runstad, underscores that for developers who are careful and experienced, participation in the 63-20 process offers ample incentives.

“In 2002, we realized that [63-20] is good business,” says Eden, who has managed six 63-20 projects for Wright-Runstad. The fee negotiated is always fair, she reports, and usually includes incentives to share in cost savings. The assumption of substantial risk requires developers to approach the project with caution, but it is the same attention to detail they would give to buildings in their own portfolio.

“We don’t submit a final price until we are sure about the project,” Eden explains. “We are thorough. We warn the government agency that they must understand what they are getting. If they want to make changes, they will be responsible for the cost of the changes.”

The company views 63-20 as a win-win undertaking, relates Eden. The fee allows for a reasonable profit and there are usually incentives to share in cost savings. But in the end, she adds, “these projects have the added reward of knowing that as taxpayers you are saving yourselves money.”

Last fall, King County, Washington, opened a new 14-story, 444,000-square-foot (41,249-sq-m) medical office building, a project originally intended to proceed in two phases using the traditional design-bid-build method. However, the project had advanced no further than digging the foundation hole and already it was well over the approximately \$105 million original budget. “Just after the hole was dug, the bids came in at \$15 million over budget. We couldn’t build it,” recalls Napolitano, who was then working for King County. “We threw the whole thing out and started again with the 63-20 process.” Finke represented the nonprofit, National Development Council, and Eden represented the developer, Wright-Runstad.

It was quickly determined that the original two-site design did not make sense. Two buildings were combined into one and construction was changed to one phase. “Part of the problem was the county wanted a medical office building, but the design was more like a hospital, so it was way over budget,” says Eden. “Government agencies often don’t finish the design—there are too many committees—the price is not guaranteed and when changes occur, the price goes up.” “Wright-Runstad led the redesign,” notes Finke of NDC, which issued the bonds to finance the project. “They built a bigger, more efficient building and ended up saving the county \$30 million.”

With 63-20, it is the nonprofit—not the government—that issues the debt and owns the facility during the bond term, which means the regulation-laden traditional public

building process can be avoided. The private sector developer, who reports to the nonprofit and not the government agency, is free and is encouraged to use private sector construction techniques. “Public works projects are such a pain in the ass, just keeping everybody honest,” adds Napolitano. Understandably, many safeguards are in place, but at times the safeguards hinder efficiency. “Private developers can do things governments can’t,” Napolitano comments. “For example, developers can go online and find a deal [for construction material] and take advantage of it. Governments can’t do that; they need to get the lowest bid.”

Finke estimates that in the close to 20 projects in Washington, savings to the state and local governments have ranged from 20 to 40 percent. “One project was close to 50 percent,” he says.

So why aren’t more government projects using the 63-20 process? Eden, for one, says she thinks it is because 63-20 is not well known nationally. Last fall, she spoke about the process at a conference of state and local public agency officials in Washington, D.C., and the response was enthusiastic. “People from other states came up to me and asked if [Wright-Runstad] would work on some of their projects,” Eden recalls. “I told them we have enough to do in Washington, but other developers would like to do this.”

The process has definitely taken hold in Washington State. According to Napolitano, a recent request for proposals to developers to build a small city hall elicited 14 responses. Elected officials have also been enthusiastic about the 63-20 process. “Politicians like [63-20] because it’s safe and cheap, and they won’t lose their job because of cost overruns,” he says. **UL**

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**NDC built and now owns the King Street Center for King County, Washington, using 63-20 bonds. The LEED (Leadership in Energy and Environmental Design) Gold-certified building is credited with saving the county two years in the development process.**

