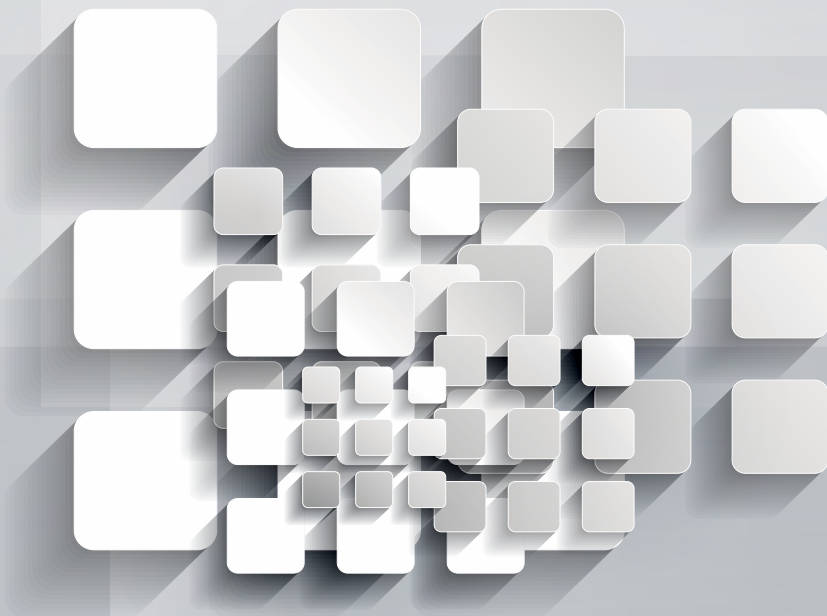




An Assessment of  
Public-Private Partnership Opportunities  
for the  
Proposed Extension of the  
San Francisco Veterans Affairs  
Medical Center  
to the Mission Bay Area of San Francisco



an analysis prepared by the



March 2014

## Foreword

The United States is facing a major infrastructure deficit, and a shortage of public funds to meet its growing needs. This is no less true of California, where the state has major requirements but lacks the resources to meet them. Public-private partnerships offer one pathway to address this challenge and build the infrastructure that will ensure our future economic competitiveness. The President's Council on Jobs and Competitiveness has addressed the infrastructure challenge at the national level, putting forward recommendations to move our economy forward. We need to be equally creative in California in addressing how to finance and develop both transportation and social infrastructure. There are many opportunities for both policy innovation and projects. This analysis demonstrates how in the case of one important project—the rebuilding of the research facilities of the San Francisco Veterans Affairs Medical Center—public-private partnership methods have the potential to advance both economic needs and public welfare.

A handwritten signature in dark ink, reading "Laura D. Tyson". The signature is fluid and cursive, with the first name "Laura" being the most prominent.

Laura D'Andrea Tyson

Professor of Business Administration and Economics  
Director, Institute for Business & Social Impact  
Haas School of Business, University of California, Berkeley  
Chair, Board of Trustees  
Bay Area Council Economic Institute



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# Acknowledgements

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The Bay Area Council Economic Institute is a partnership of business with labor, government, higher education and community leaders that works to support the economic vitality and competitiveness of California and the Bay Area. It produces authoritative analyses on key economic issues in the region and the state, and mobilizes leaders from diverse backgrounds around targeted policy initiatives. A sought-after source of economic perspective, its public-private governance and fact-based approach to economic analysis underpin the Institute's forward-looking thought leadership.

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Editor’s Note: Capitalization of the word “Veterans” in this publication follows the style adopted by the U.S. Department of Veterans Affairs.

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# Introduction

The San Francisco Veterans Affairs Medical Center (SFVAMC) is a leading Department of Veterans Affairs (VA) academic medical center. In partnership with the University of California, San Francisco (UCSF), SFVAMC advances a national agenda for Veterans health. With over 22 million Veterans living today, and many complex and traumatic injuries resulting from the recent wars in Iraq and Afghanistan, its mission is critically important not only to Veterans, but to the medical community and the broader population. Providing one-third of the clinical education curriculum for residents and medical students of the UCSF School of Medicine, SFVAMC engages top level academic faculty in the provision of clinical care and leading edge research to help the nation's Veterans community. Its research program is the largest in the national VA system.

The SFVAMC's future is at risk, however. The ability to maintain its Veterans health research program, in particular, is impacted due to space shortfalls and the inability to expand at its current site at Fort Miley in San Francisco. Having reached critical limits, the best course to ensure SFVAMC's future health and advancement is to relocate some or all of its research and clinical activities, including telehealth functions, to a new site. In this context, there are collaborative advantages to having this move bring SFVAMC's activities into closer proximity to its 40-year partner institution, UCSF, near the growing life sciences complex in San Francisco's Mission Bay district.

The SFVAMC's ability to develop a financially viable project is at present severely constrained by current limitations in the appropriations that fund the VA capital improvement program. These funds are critically backlogged and are insufficient to meet not only the SFVAMC's needs but also the VA's current and future requirements on a national scale.

At the present heavily curtailed rate of appropriations, the federal backlog of VA-approved but only partially funded capital projects is conservatively projected to require a wait of 10–15 years for major capital projects (those in excess of \$10 million) such as the proposed SFVAMC Extension.<sup>1</sup> In addition to this appropriations delay, recent U.S. Government Accountability Office (GAO) analysis of 50 major VA projects showed that of the 30 projects complete or under construction, 23 (or 76.6%) have suffered completion delay. The remaining 20 projects are in various stages of Design Development/Schematics and have no indications regarding schedule.<sup>2</sup> In light of

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<sup>1</sup> U.S. Department of Veterans Affairs, Office of Budget. Annual Budget Submission, Fiscal Year 2013. Volume IV: Construction and Long Range Capital Plan. pp 698; pp 10–58 to 10–01. [http://www.va.gov/budget/docs/summary/Fy2013\\_Volume\\_IV-Construction\\_Long\\_Range\\_Capital\\_Plan.pdf](http://www.va.gov/budget/docs/summary/Fy2013_Volume_IV-Construction_Long_Range_Capital_Plan.pdf).

<sup>2</sup> GAO Report. "VA CONSTRUCTION: Additional Actions to Decrease Delays and Lower Costs of Major Medical-Facility Projects." April 2013. <http://www.gao.gov/assets/660/653585.pdf>.

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these issues, there is a clear and timely need for innovation in how the capital needs of the Veterans Administration are met.

This analysis finds that there is an immediate opportunity for the VA to pilot an alternative financing and execution strategy around the proposed SFVAMC Extension, using a public-private partnership (P3) procurement. The P3 model is well-developed globally, with extensively documented cost and delivery advantages of 10–30% over conventional procurements.<sup>3</sup> With support at the city, state and federal levels, a successful P3 delivery of the SFVAMC Extension can not only meet the SFVAMC's pressing needs, but also show a path for worthy VA capital projects to move forward nationally. As Secretary Eric Shinseki of the Department of Veterans Affairs states in a 2013 Memo on Public-Private Partnerships:

- 1. In today's inter-connected world, the U.S. Department of Veterans Affairs (VA) cannot operate alone. In order to meet VA's fiscal year (FY) 2014–2020 strategic goal to enhance and develop trusted partnerships and address the large scale and complex challenges requiring cross-sector solutions and collaboration, VA engages in public-private partnerships that leverage the full range of our nation's talent, ingenuity, and commitment to action. These partnerships not only further the Department's mission and priorities, but also build capacity and create platforms for sharing resources to better serve Veterans, their families, caregivers, Survivors, and beneficiaries.*
- 2. It is imperative that VA continue fostering these public-private partnerships, in a responsible and productive manner, and seek out other partnerships opportunities when and where appropriate.<sup>4</sup>*

A timely SFVAMC Extension that reaches completion on a 3-year timeline would build on—and potentially accelerate—current collaborative successes in research, training and treatment between the SFVAMC and UCSF. On the other hand, a 10–15 year delay scenario will result in newly diagnosed Veterans with PTSD and traumatic brain injuries receiving less advanced and more constrained care than they might have received under an accelerated P3 delivery. Sufferers of Alzheimer's, Parkinson's and spinal injury in both the Veterans community and the general population may wait on breakthroughs in diagnosis and treatment that new and expressly collaborative research facilities would support.

This analysis will examine a globally proven P3 delivery model that leverages private capital, efficiency, timeliness, transparency and accountability to serve public objectives in essential social infrastructure (e.g., schools and hospitals) and will evaluate its application to the immediate needs and long-term objectives of the SFVAMC Extension. The project is presented as a pilot to assess the potential applicability of P3 to the VA's capital needs at large.

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<sup>3</sup> Infrastructure Partnerships Australia. "Performance of PPPs and Traditional Procurement in Australia." June 2012. IPA\_PPP\_FINAL.pdf. <http://www.infrastructure.org.au/DisplayFile.aspx?FileID=450>

<sup>4</sup> See Appendix E.



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# Executive Summary

## P3: An Alternative Execution and Financing Strategy

The public-private partnership (P3) is a model that has become standard practice in developed countries. Even where public funding is readily and inexpensively available, as in British Columbia, the P3 option is frequently adopted for reasons of performance, time and budget certainty, and execution, and not solely or even primarily for the access to private capital that it provides.

Projects above \$100 million in scale—such as the proposed SFVAMC Extension—are considered particularly vulnerable to cost and schedule overruns on the conventional delivery track. This is apparent in recent GAO analysis of VA major projects, as well as in an analysis of 152 highway construction projects in California procured through Design-Bid-Build (DBB) methods. That analysis found that the 26 projects with values above \$100 million (in 2009 dollars) had final costs that were on average 25% higher than the original engineers estimate; all five of the largest projects (valued over \$300 million) experienced even higher overruns.<sup>5</sup> This suggests that as project size and complexity increase, so does the likelihood of large cost overruns. This finding is confirmed in comparative analyses internationally. Canada, notably, has found P3 delivery of larger scale projects to be advantageous enough that it has federally mandated all projects C\$100 million and above to be screened as potential P3s to determine if cost, schedule, and performance certainty advantages can be gained.<sup>6</sup>

This analysis, which draws on a review team of contributors with extensive experience in alternative project delivery, considers the application of such alternative delivery strategies to the proposed SFVAMC Extension. Those strategies encompass funding, development, construction, and life cycle operations and maintenance that could be provided to the SFVAMC by the private sector and that are contrasted to the conventional public appropriation and delivery path.

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<sup>5</sup> Arup/Parsons Brinckerhoff Joint Venture. "Analysis of Delivery Options for the Presidio Parkway Project." February 2010. Commissioned by the California Department of Transportation and the San Francisco County Transportation Authority. [http://www.presidioparkway.org/project\\_docs/files/presidio\\_prkwy\\_prjct\\_bsnss\\_case.pdf](http://www.presidioparkway.org/project_docs/files/presidio_prkwy_prjct_bsnss_case.pdf).

<sup>6</sup> PPP Canada. "Identifying P3 Potential: A Guide for Federal Departments & Agencies." 2012. [http://www.p3canada.ca/files/file/FederalP3Screen\\_UserGuide\\_en.pdf](http://www.p3canada.ca/files/file/FederalP3Screen_UserGuide_en.pdf).

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## Findings

This analysis concludes that

- the development of an Extension facility for the SFVAMC is feasible as a public-private partnership, and if structured properly in its documentation and credit structure, would be an investment grade transaction attractive to private capital;
- developing the project as a P3 could result in the accelerated availability of the Extension facility to meet the urgent needs of the SFVAMC and the Veterans it serves;
- if developed as a P3, the project could achieve capital cost savings of at least 20%, compared to conventional federal government procurement methods, and life cycle cost savings (including operations and maintenance) of 10-30%.

These findings are supported by evidence from similar projects globally that the value of transferring DBFOM (Design-Build-Finance-Operate-Maintain) risk to a private partner not only unlocks capital seeking the financial returns associated with that risk transfer, but as a result of that risk transfer can tighten completion schedules, curtail change orders and cap cost, bring design into alignment with efficient operations, and ensure cost-effective maintenance performance by the private partner for the life of the agreement.

## Legislative and Directive Recommendations

Advancing this project as a P3 with the federal government as the public partner requires its classification by the Office of Management and Budget (OMB) as an operating lease transaction, as opposed to a capital lease transaction. A capital lease classification would call for an up-front budget appropriation for the full value of all payments over the life of the agreement. This would render a P3 delivery method highly unlikely due to the lack of funding capacity in the VA's capital budget and the considerable backlog of projects awaiting full appropriation.

In contrast, an operating lease transaction would require only the recognition of an annual appropriation for the SFVAMC. This study therefore recommends that the VA pursue legislation and/or directives allowing a pilot P3 project at the SFVAMC to move forward with an operating lease classification. Removing the barrier of capital lease classification could also benefit other VA projects facing appropriations constraints and completion delays.

Detailed recommendations for legislative or directive measures to enable the development of a pilot P3 for the SFVAMC by allowing the classification

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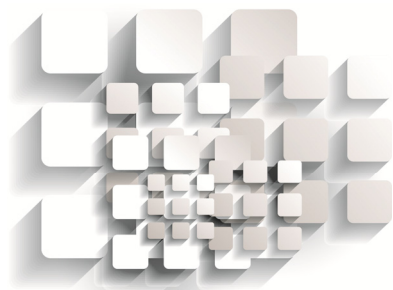
of the transaction as an operating lease, not a capital lease, are discussed in broad form at the close of this paper, but warrant the engagement of legal experts to refine.

## Site Options Urgency

The optimal sites for the integration of SFVAMC into the Mission Bay area are on property currently available and owned by private parties near UCSF's new medical center and life science campus. Such collocation would allow SFVAMC to benefit from closer proximity to its collaborative partner, UCSF, and to continue the successful inter-disciplinary research model linking UCSF with SFVAMC. As those sites will not be available indefinitely, it is important that the necessary legislation and/or directives enabling a pilot project to move forward be pursued on an expedited basis.

## Conclusion

This study finds that the cost of P3 financing would be somewhat higher than an eventual federal appropriation but would be available without delay and could yield significant overall savings and benefits. Such savings would derive from the P3 model's proven speed of execution, improved transparency, up-front due diligence and planning, avoided costs of delay, budget certainty, and improved life cycle performance and accountability—the benefits of full DBFOM risk transfer to the private sector. A P3 procurement therefore appears to be the most effective means to achieve the core objectives of the SFVAMC for the new facility: optimizing research collaboration with UCSF, addressing space deficiencies, fostering SFVAMC's research leadership, and bringing improved treatments and services to the Veterans community in an accelerated manner.



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# An Assessment of Public-Private Partnership Opportunities for the Proposed Extension of the San Francisco Veterans Affairs Medical Center to the Mission Bay Area of San Francisco

This study examines the feasibility and potential benefits of using a public-private partnership (P3) procurement and delivery method to design, build, finance, operate and maintain a new SFVAMC facility, providing laboratory research space in the Mission Bay area of San Francisco at a site near the VA's research and clinical education partner, the University of California, San Francisco (UCSF). In doing so, it compares P3 procurement to the traditional public financing mechanism of federal appropriation and Design-Bid-Build (DBB) project delivery. It specifically models and analyzes three potential cases, all assuming a total facility size of 343,500 gross square feet. This breakdown assumes 150,000 gross square feet for VA biomedical research and telemedicine clinical outreach programs, and 193,500 gross square feet for other tenants, including UCSF.

This study also evaluates the potential for cost savings and timeline compression with a private partner, as seen in the Sandler Neurosciences Center, a hybrid P3 Design-Build-Operate-Maintain (DBOM) research facility project recently undertaken by UCSF. This case will be compared to recent VA medical center projects developed under a conventional DBB government procurement model.

P3 methods have been used successfully to build and operate transportation, energy, utility and social infrastructure (e.g., schools and hospitals) projects throughout the world, with decades of precedent in the United Kingdom, Europe, South America, Canada and Australia. In the United States, P3 has been used on a much more limited basis. To date, the largest activity has been in transportation, but P3 delivery methods have also been applied in social infrastructure including university housing and facilities, federal buildings, courthouses, and military base housing. P3 delivery methods are beginning to be used in the upgrade of water and wastewater infrastructure in the U.S. as well. The overall assessment from this sizeable body of global experience has been positive, with life cycle cost savings in representative projects of 10–30%, and significant improvements in the timing of

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project completion and service delivery.<sup>7</sup> While the U.S. appears to be approximately 20 years behind its international counterparts, there is ample documentation on global best practice, as well as expertise in the U.S., to inform and support a potential P3 development by the VA.

## The San Francisco VA Medical Center

The Department of Veterans Affairs (VA) is the federal government agency that directly serves America's Veterans and their families. The VA comprises a Central Office (VACO), located in Washington, D.C., and field facilities throughout the nation administered by its three major line organizations: the Veterans Health Administration, the Veterans Benefits Administration, and the National Cemetery Administration. Services and benefits are provided through a nationwide network of 153 medical centers, 956 outpatient clinics, 134 community living centers, 90 residential rehabilitation treatment programs, 232 Veterans Centers, 56 Veterans Affairs Regional Offices, and 131 National Cemeteries.

California is home to 9% of all U.S. Veterans, and half of those California Veterans live in Northern California. The San Francisco Veterans Affairs Medical Center (SFVAMC) is a tertiary care facility serving the Veterans community with 124 operating beds, a 120-bed community living center (CLC), and six community based outpatient clinics (CBOCs), one of which is a specialized homeless Veterans' clinic. In Fiscal Year (FY) 2012, the SFVAMC accommodated nearly 900,000 outpatient encounters and approximately 28,000 inpatient visits. This includes recent Veterans of the Iraq and Afghanistan conflicts. Outpatient visits have increased and are projected to increase further due to the aging Vietnam Veteran population, and the complications associated with the complexity of injuries sustained by Veterans of the Iraq and Afghanistan conflicts.

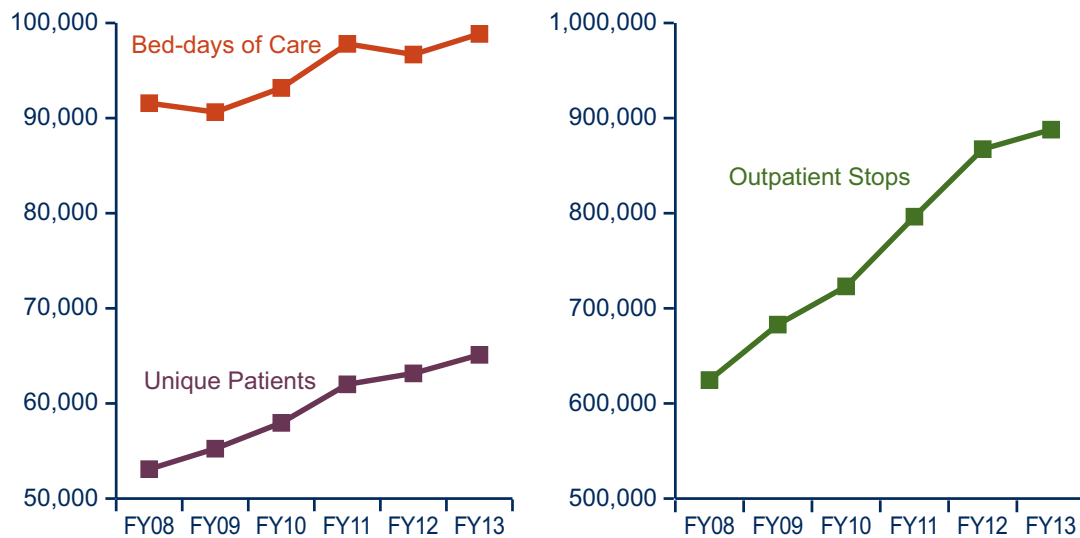
The SFVAMC has been collaborating with the UCSF School of Medicine for over 50 years, with all physicians jointly recruited, and academic, treatment and research programs that are integral to one another. Recent reports confirming the vital role of VA medical centers in collaboration with their academic affiliates suggest the strategic nature of this relationship. The Blue Ribbon Panel on VA-Medical School Affiliations (2006) "recommends that VA and its academic partners redouble their efforts to develop new knowledge through collaborative research."<sup>8</sup>

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<sup>7</sup> Infrastructure Partnerships Australia. "Performance of PPPs and Traditional Procurement in Australia." June 2012. IPA\_PPP\_FINAL.pdf. <http://www.infrastructure.org.au/DisplayFile.aspx?FileID=450>

<sup>8</sup> Blue Ribbon Panel: Federal Advisory Committee on Veterans Affairs Medical School Affiliations. "The Report of the Blue Ribbon Panel on VA-Medical School Affiliations: Transforming an Historic Partnership for the 21st Century." <http://www.va.gov/oaa/archive/BRP-final-report.pdf>.

## Care Provided by SFVAMC and Community Based Outpatient Clinics, Fiscal Years 2008–2013



Source: VA Patient Cost and Workload Data Cubes

Note: Bed-days of Care measure inpatient workload, Unique Patients are individual Veterans who sought healthcare at least once in the fiscal year, and Outpatient Stops measure outpatient clinical encounters for different types of care.

The Veterans Health Administration (VHA) leadership in the journal *Academic Medicine* (August 2011), also notes:

*... physicians in the Veterans Health Administration (VA) who spend time in research have greater overall job satisfaction, that satisfaction tracks with aggregate facility research funding, and that satisfaction is higher among physicians working in VA facilities located on the same campus or within walking distance of an affiliated medical school.... these findings suggest that an environment of discovery and learning may yield benefits beyond specific academic endeavors and contribute more broadly to supporting health system performance.<sup>9</sup>*

The SFVAMC hosts National Centers of Excellence in the areas of epilepsy treatment, cardiac surgery, post-traumatic stress, HIV, renal dialysis, and other nationally recognized programs including the Parkinson's Disease Research,

<sup>9</sup> National Center for Biotechnology Information. Abstract. (David C. Mohr PhD and James F. Burgess, Jr. PhD, "Job Characteristics and Job Satisfaction Among Physicians Involved with Research in the Veterans Health Administration," *Academic Medicine*: August 2011–Volume 86 –Issue 8–pp 938-945). <http://www.ncbi.nlm.nih.gov/pubmed/21795900>

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Education, and Clinical Center; the Hepatitis C Research and Education Center; the Mental Illness Research and Education Clinical Center; and the VA's Pacemaker and AICD Surveillance Program. The SFVAMC is designated as one of only five VA Centers of Excellence in Primary Care Education, and is one of only 12 locations in the country designated to serve homeless and at-risk Veterans and their families.

The SFVAMC has the largest funded research program in the national VA system, with 55% more grant funding than any other VA facility and over \$87 million in research funding expended in FY 2012. It is one of a handful of institutions equipped for studies using both whole-body magnetic resonance imaging (MRI) and spectroscopy, and it is home to the VA's National Center for the Imaging of Neurodegenerative Diseases. The SFVAMC has also established a unique partnership with the Department of Defense to study the basic neuroscience and neuroimaging of combat-related brain and spinal cord injuries, PTSD, and other neurological combat-related injuries and predictors of injuries in war fighters.

With the diversity of services and research it delivers, SFVAMC has gained national recognition as an important academic medical center. This distinction and the SFVAMC's ability to serve Veterans at its current level is compromised, however, by aged infrastructure and a remote location. Taken together, these issues present severe capacity, accessibility and collaboration challenges.

## The Issue: Inadequate and Physically Constrained SFVAMC Facilities at the Fort Miley Site

SFVAMC, which occupies over 1.1 million square feet in 38 buildings on 29 acres, has been located at its current Fort Miley site since 1934, when it was built under the Works Progress Administration (WPA). The facility is now aged, with "D" and "F" graded infrastructure deficiencies. Correction of these deficiencies and/or their replacement may be financially infeasible and physically impractical, as many buildings are on the National Register of Historic Places. Due to their age and use, the facilities are also expensive to operate and maintain and difficult to align with the latest in medical research and treatment technologies. From a user standpoint the site has inadequate parking and is served by limited public transportation via a single bus route, making it difficult for Veterans and others to access.

On top of the qualitative deficiencies of the current facilities, the SFVAMC's Long Range Development Plan (LRDP) has identified a 485,500 gross square



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foot space deficiency. These findings indicate a need to expand on the present site or relocate a portion of the uses presently located there. It is difficult to expand at the existing site, however, due to a lack of potential building sites and an inability to procure additional acreage nearby.

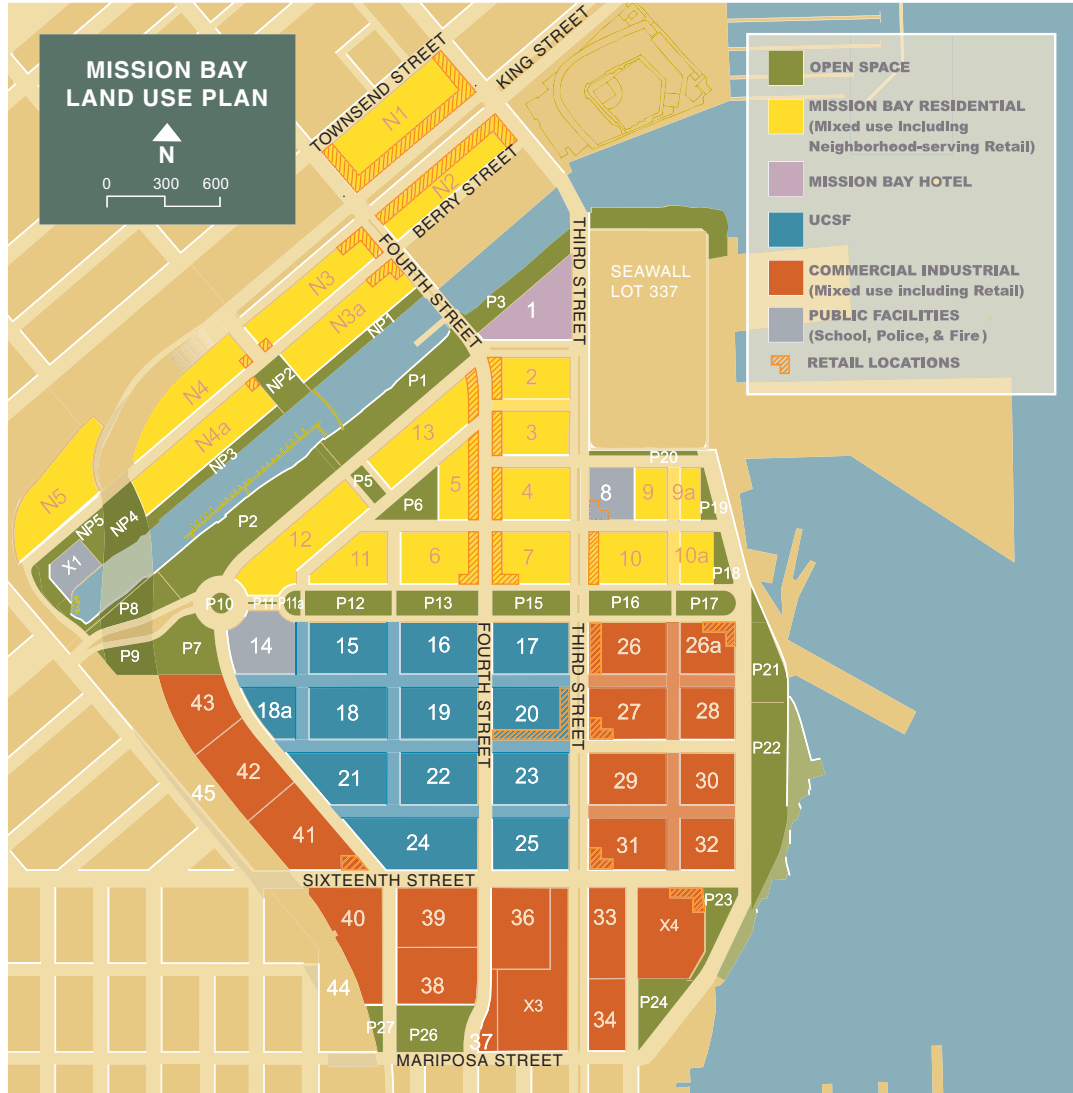
## Collaboration: The UCSF Opportunity at Mission Bay

UCSF opened its first research building in Mission Bay in 2003. Since then, the University has expanded its presence there, and strategic plans call for moving the majority of its research to Mission Bay from its overcrowded Parnassus campus. One of UCSF's research buildings in Mission Bay and two recent VHA hospital projects will be reviewed later in this study, contrasting the use of a P3 procurement to a conventional procurement as two differing approaches to constructing and operating facilities of this nature.

UCSF's 57-acre campus at Mission Bay is part of the 303-acre Mission Bay Redevelopment Area, which is divided into 2 sub-areas: Mission Bay North and Mission Bay South. The Redevelopment Plan for Mission Bay South covers 238 acres, including an initial campus of 43 acres for UCSF. In addition to these 43 acres, over 14 acres have been dedicated for UCSF's new Medical Center housing three hospitals: the UCSF Benioff Children's Hospital, the UCSF Betty Irene Moore Women's Hospital, and the UCSF Cancer Hospital.

In the Mission Bay South Redevelopment Plan, UCSF is positioned to be a catalyst for the development of additional biomedical research activity, creating an extended life sciences complex embracing university research, pharmaceutical, and corporate biotechnology activity. A move by the SFVAMC to be closer to UCSF at Mission Bay would align with the objectives of the Redevelopment Plan and with the city's goal of establishing San Francisco as a major biotechnology and life sciences center. Preliminary discussions with the Mayor's Office, Planning Department staff, and the Redevelopment Agency's successor agency have all indicated support for a VA presence in Mission Bay. With these objectives, the recent lease by SFVAMC of 42,000 square feet of research space at Mission Bay has been welcomed by both the research community and the Mayor's Office.

If the SFVAMC does not locate a portion of its research space close to UCSF, its partnership with the University will be under growing stress. Today, VA researchers collaborating with their UCSF Mission Bay colleagues face a 55 minute drive by car between Ft. Miley and Mission Bay, and a trip of more than twice that time using public transit. This results in a loss to productivity that is undermining to the SFVAMC's research mission and outcomes.



## The Proposed SFVAMC Extension

Potential sites for the proposed SFVAMC Extension in or near the Mission Bay Redevelopment Project area have been studied and currently include Block 40 which is owned by Farallon Capital; Seawall Lot 337 which is owned by the Port of San Francisco and controlled by the San Francisco Giants; Pier 70, which is Port property and is planned for a mix of commercial and residential uses by Forest City Enterprises; and the former Salesforce campus site next to UCSF (Blocks 26, 27, 29, 30, 31, 32, 33 and 34).

- **Block 40** is part of the Mission Bay South Redevelopment Plan Area, and thus has entitlements that would favor an SFVAMC build-out of a largely biomedical research facility. A conditional use process would need to be

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pursued, as well as the study of potential traffic and transit impacts that would occur due to the possible change of use. These actions would be needed to perfect the entitlements for an SFVAMC presence.

- **Seawall Lot 337** is not yet entitled for the currently planned residential or commercial uses and a site within this area would be an attractive location for the proposed SFVAMC Extension. The ability of a P3 partner to develop a building on this property would be delayed by at least a year, however, due to the current lack of entitlements compared to the other sites.
- **Pier 70** is a project to bring two million plus square feet of commercial and residential development to an historic ship repair site south of Mission Bay. The Pier 70 site is also not entitled and faces years of hazardous materials clean-up. This would place it several years behind any of the other potential sites in being available for tenant occupancy.
- The **former Salesforce campus** at Mission Bay is a 14-acre site (Blocks 26, 27, 29, 30, 31, 32, 33 and 34) entitled for the development of an approximately 2,000,000 square foot headquarters for Salesforce.com. In 2012, Salesforce announced that it would no longer pursue the site as its future home, leaving this entitled area available for development by other parties. With several parcels immediately adjacent to UCSF and its new hospitals, the Salesforce property offers a particularly attractive location.

## Fort Miley Reuse

Once SFVAMC has gained sufficient space in Mission Bay or elsewhere to address a portion of its 485,500 square foot space deficiency, future shifts of functional space away from the Fort Miley site could provide opportunities for revenue generation and further cost-savings, as the historic buildings there are expensive to maintain and, once vacated, would be available for conversion to other uses such as Veterans or faculty housing. Such a change of use could potentially generate cash flow that would be available to support the SFVAMC's new facility at Mission Bay. Compared to more high-intensity uses, the development of Veterans or faculty housing at Fort Miley would also be a less intense utilization of the site, potentially addressing neighborhood concerns regarding the current high level of visitor activity.

All agencies of the federal government have some authority to enter into long-term agreements to rehabilitate and restore historic buildings, although additional congressional authorization is often needed. In this regard, the Presidio Trust, empowered by enabling legislation, has successfully restored most of the existing buildings at the Presidio of San Francisco, often with private-sector partners. The Bay Area Council Economic Institute team

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has visited Fort Miley, together with experts in the field of affordable and market rate housing, to assess this possibility. The consensus was uniformly positive for such a change of use, particularly considering the attractive setting of surrounding park lands, the Legion of Honor fine arts museum, trails, a golf course, and ocean views.

The Economic Institute team was also encouraged by the fact that the 1934 buildings at Fort Miley are on the National Register of Historic Places. Such a designation allows for the use of Historic Tax Credits for financing their redevelopment, making the opportunity potentially more attractive for private partners.

A second Economic Institute study, requested by NCIRE – The Veterans Health Research Institute and to be completed in 2014, will more fully assess this potential. Such a reuse plan would contemplate converting a small portion of the site in the initial phase, with larger conversions taking place in the future if the scale of relocating SFVAMC programs to Mission Bay increases.

## SFVAMC and UCSF Partnering Possibility

UCSF announced in September 2012 that it plans to add 850,000 gross square feet of additional space to its 57-acre Mission Bay campus. Sources at UCSF had earlier indicated that the University needs to consolidate approximately 300,000 gross square feet of office and administrative space from leased premises elsewhere in the Bay Area to be near Mission Bay. Discussions with the University indicate that UCSF believes this need could be satisfied by building on the adjacent Salesforce blocks, possibly in conjunction with the SFVAMC. An RFQ seeking a private partner/developer to build such a facility for UCSF was issued in December 2012.

Representatives of UCSF have indicated that were the university to build off-campus in Mission Bay, it would prefer to do so with a private partner using a P3 transaction model. In this operating lease scenario, it would not use its own capital resources to back the financing, but would look to its private partner to raise the necessary capital. These sources also indicated that UCSF could be interested in joining SFVAMC in a facility occupied by both entities and built by a private partner through a P3 procurement process. UCSF's successful experience in developing the Sandler Neurosciences Center with a private partner, under a DBOM procurement approach where risk was transferred to the private partner for all elements except financing, is discussed in detail below. The collocation of SFVAMC and UCSF in a joint facility would bring obvious program benefits to both entities and to the constituencies they serve.

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## SFVAMC Comparative Analysis: DBFOM Versus DBB

After meeting with several general contractors with experience in biomedical facility construction and with VA personnel with similar experience, the Economic Institute team has developed one facilities construction budget using a P3 DBFOM procurement approach and another using a conventional DBB procurement model. The analysis which follows shows that substantial improvement in execution certainty, timeline compression, risk transfer and cost savings can be captured if a P3 DBFOM approach is used to develop a new VA facility.

Four scenarios are examined:

1. **Publicly Funded Procurement Best Case Timeline:** The new SFVAMC facility is financed through traditional appropriations or public financing means, with the VA retaining the associated risks of delivering a project through a Design-Bid-Build (DBB) project delivery process and with construction assumed to commence in 2015. This case presumes that the project is able to jump the queue of VA Major Projects and achieves full funding ahead of the current appropriations schedule.
2. **Publicly Funded Procurement Backlog Timeline:** The new SFVAMC facility is financed through conventional appropriations or public financing means, with the VA retaining the associated risks of delivery through a DBB project delivery process. Under this scenario, however, based on appropriations constraint and queue delay, the project begins construction in the mid-2020s.
3. **Public-Private Partnership Lower Cost Scenario:** The facility is completed with private capital, and the risks associated with project delivery and life cycle operations are shifted to a private partner through a Design-Build-Finance-Operate-Maintain (DBFOM) procurement. Private debt and equity are raised to support the project, with construction assumed to commence in 2015. Capital cost assumptions are provided by private contractor estimates.
4. **Public-Private Partnership Higher Cost Scenario:** The facility is completed with private capital, and the risks associated with project delivery and life cycle operations of the facility are shifted to a private partner through a DBFOM procurement. Private debt and equity would be raised to support the project, with construction assumed to commence in 2015. Capital cost assumptions are derived from private sector costs based on VA provided assumptions.

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Several observations are in order regarding the methodology behind this analysis.

Both the Publicly Funded cases and the P3 Higher Cost Scenario incorporate capital costs derived from the VA's own cost methodology. Private contractors who were consulted in the development of the study, however, maintain they could deliver the capital cost of the SFVAMC Extension at a dramatically lower total capital cost than under VA assumptions, estimating \$879 per square foot for the P3 Lower Cost Scenario versus \$1,217 per square foot for the P3 Higher Cost Scenario (derived from VA assumptions) and \$1,594 per square foot in the VA's Publicly Funded Procurement Best Case scenario.

The 10–15 year delay assumptions in the conventional Publicly Funded Procurement Backlog scenario for the VA's major capital projects reflect appropriations delay only and do not reflect recent U.S. Government Accountability Office (GAO) findings regarding the VA's record on completion delay. Noting that the GAO's findings are not necessarily endorsed by the VA, due to differences of opinion regarding methodology, the GAO analysis of 50 major VA projects showed that of the 30 projects complete or under construction, 23 (or 76.6%) have suffered completion delay. The remaining 20 projects are in various stages of Design Development/Schematics and have no indications regarding schedule.<sup>10</sup>

It should be noted that the VA is taking steps to improve its construction management practices so as to contain cost and schedule overruns, including the establishment of the Construction Review Council and ongoing implementation of the SCIP process as described in the introductory notes for the U.S. Department of Veterans Affairs Long Range Capital Plan:

*The Strategic Capital Investment Planning (SCIP) process is an innovative Department-wide process designed to improve the delivery of services and benefits to Veterans, their families, and their survivors, with the safest and most secure infrastructure possible, by addressing VA's most critical needs first; investing wisely in VA's future and significantly improving the efficiency of VA's far-reaching and wide range of activities.*

*VA uses the best infrastructure planning practices from both the private and public sectors to integrate all capital investment planning for major construction, minor construction, non-recurring maintenance and leasing.<sup>11</sup>*

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<sup>10</sup> GAO Report. "VA CONSTRUCTION: Additional Actions to Decrease Delays and Lower Costs of Major Medical-Facility Projects." April 2013. <http://www.gao.gov/assets/660/653585.pdf>.

<sup>11</sup> U.S. Department of Veterans Affairs, Office of Budget. Annual Budget Submission, Fiscal Year 2013. Volume IV: Construction and Long Range Capital Plan. p i. [http://www.va.gov/budget/docs/summary/Fy2013\\_Volume\\_IV-Construction\\_Long\\_Range\\_Capital\\_Plan.pdf](http://www.va.gov/budget/docs/summary/Fy2013_Volume_IV-Construction_Long_Range_Capital_Plan.pdf).

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Until such time as these past and current VA measures to improve delivery take effect, the combined potential impact on the SFVAMC's delivery schedule of appropriations delay on the one hand, and completion delay on the other, should be taken into consideration when considering alternative delivery methods.

Contemplating potential delays of this severity for an otherwise straight-forward construction project puts a conventional comparison of public versus private financing into uncommon territory. The standard comparative analysis of public-private partnerships globally and domestically contrasts between a public case and a private case such factors as cost of capital, life cycle cost savings, performance, risk transfer costs, and benefits. In the SFVAMC scenario, however, this analysis must be expanded to account for expected appropriations delay in a public case of 10–15 years, with an additional 29 months of completion delay on average. The Economic Institute's analysis quantifies the difference in costs between a facility reaching completion in 2–3 years under a P3 case and that same facility becoming available in the mid-2020s under a conservatively assessed public case.

Quantifying the difference in value between the two scenarios—be it value to the Veterans served by SFVAMC, or value to all those benefiting from SFVAMC's advanced research in brain trauma, Alzheimer's and other pressing national health issues—is even more challenging. The opportunity costs associated with such a delay verge on the generational in scale and impact.

To ensure that this analysis is conservative, a consideration of cost overruns in past or current VA projects was also not included in the public-private comparator. Findings by the GAO regarding cost increases across the 50 major projects, while challenged by the VA, are nevertheless contextually relevant to this study's analysis. While the authors did not include any assumption of cost overrun in a public case, the GAO found that of the 50 projects studied, 46% were over budget, with an average cost overrun of 77%.<sup>12</sup> If the 77% average overrun on major projects were to be included in a conventionally funded public scenario, the comparative cost effectiveness of P3 delivery would be significantly greater.

Finally, a note is in order regarding the comparative merits of front-end public versus private financing and their respective impacts on a project's bottom line. Despite the fact that engaging a private partner can result in higher up-front financing costs (i.e., private financing versus federal appropriation), global and domestic case studies show that the innovations and efficiencies employed by private partners have the potential to more than offset these costs. Savings provided by shortened construction timelines and the ability to eliminate or limit change orders can result in dramatic cost

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<sup>12</sup> GAO Report. "VA CONSTRUCTION: Additional Actions to Decrease Delays and Lower Costs of Major Medical-Facility Projects." April 2013. <http://www.gao.gov/assets/660/653585.pdf>.

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reductions when compared to a conventional DBB government procurement approach (thus limiting cost escalation and leading to quicker revenue generation). Global experience also shows that by assigning the operations and maintenance risk to a private partner through a performance-based contract covering the life of the agreement, life cycle costs can be lowered to a level that can further compensate for higher private financing costs. In general, the private sector is often able to bring management efficiencies and technical expertise to enhance the asset or service in a way that would not be possible without private sector involvement.

It should be further noted when considering the relative advantages of public versus private finance that financing typically accounts for only 25% of total project cost. Of this amount, the appropriated versus private cost of capital differential is in the range of 1–2%, which conservatively might translate to 5% of total project cost. This leaves 95% of total cost as an area of opportunity for additional financial and performance improvement. The Institute’s team found that these factors, which are common to P3 projects generally, are fully applicable to a potential SFVAMC Extension as a P3.

## Financing Case Study

These methodological considerations having been noted, the analysis on pages 20–21 compares developing the proposed SFVAMC Extension through a P3 DBFOM procurement—allowing for the transfer of design, construction, financing, operation, and maintenance risk to the private partner—to developing the facility using a conventional public procurement model under which the VA would retain all project risk and which, in the current appropriations environment, would subject the procurement to an expected 10–15 year delay.

For the purposes of this analysis, the assumed year to commence construction is 2015 for the P3 DBFOM scenarios and the Publicly Funded Procurement Best Case scenario. For the Publicly Funded Procurement Backlog scenario, construction is estimated to begin in 2025. Current federal budgetary dynamics also suggest a tacit risk that the appropriation funding would become entirely unavailable by that time. The opportunity cost and the expense of investing in the preliminary development of the project under this uncertainty are risks that should arguably be priced and modeled into any public-private comparator. It is, however, unusual to produce financial models calculating the cost of a stalled or failed public project.

The Publicly Funded Procurement Backlog scenario was developed to show the impact that the delayed VA appropriations cycle could have on the project if, as appears likely, funds to commence construction are not readily available. The capital costs, both direct and indirect, presented in the analysis



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for the P3 Higher Cost and the Publicly Funded Procurement scenarios, are an amalgam of costs that were provided largely by VA personnel expert in the VA's methodology of estimating the cost of VA-built biomedical buildings and costs provided by private-sector contractors for the P3 Lower Cost scenario.

The P3 Higher Cost scenario points to a 10% life cycle costs savings and the P3 Lower Cost scenario points to a 28% life cycle cost savings, versus the Publicly Funded Procurement Best Case scenario, and 40% to 52% versus the Publicly Funded Procurement Backlog scenario. A detailed analysis of how these costs savings were derived is presented in Appendix C.

A P3 DBFOM transaction, although complex to execute, could allow for a taxable bond issue by the private partner or a private debt placement that would provide financing to be recovered through lease payments paid by the VA and the other tenants collocated with the VA. UCSF or other biomedical research institutes would be an ideal fit for that role. In this scenario, the VA could purchase or ground lease the land, with the VA, UCSF or others as tenants in a facility to be built through a leaseback to a private partner.

For this analysis, the Economic Institute assumes a joint VA and UCSF/Other Tenant approach where the VA occupies 150,000 square feet and UCSF/Other Tenants occupy 193,500 square feet, for a total of 343,500 square feet. The Institute foresees a private partner engaging in a long-term agreement to develop the facility and provide for its ongoing operation and maintenance in exchange for annual payments secured from the VA and other tenants through leases for space. The term of the lease would be ideally for 30–50 years to accommodate the financing and contractual commitments of the P3, as seen in the duration of agreements governing the new Long Beach Courthouse P3 (see Case Study 2 on page 26). At present, however, this option is precluded by a 20-year cap on lease terms at the federal level for the VA. This study recommends lifting this cap as a key legislative and/or directive action.

**P3 DBFOM versus Conventional Public Structures Economic Analysis Summary**  
(\$ thousands unless otherwise noted)

	SCENARIOS			
	P3 Lower Cost DBFOM 2015	P3 Higher Cost DBFOM 2015	Publicly Funded Best Case 2015	Publicly Funded Backlog 2025
<b>PARAMETERS</b>				
Duration (years)	20	20	20	20
Construction period (years)	2	2	3	3
VA (square feet)	150,000	150,000	150,000	150,000
UCSF/Other tenants (square feet)	<u>193,500</u>	<u>193,500</u>	<u>193,500</u>	<u>193,500</u>
Total (square feet)	343,500	343,500	343,500	343,500
Lease/O&M payments during construction	No	No	N/A	N/A
<b>USES OF FUNDS</b>				
<b>Total Capital Costs</b>	301,833	417,920	547,502	865,378
Capital costs per square foot (in \$s)	\$879 per sq. ft.	\$1,217 per sq. ft.	\$1,594 per sq. ft.	\$2,520 per sq. ft.
<b>Capital cost savings for P3 Lower Cost versus conventional scenarios</b>	–	–	<b>45%</b>	<b>65%</b>
<b>Capital cost savings for P3 Higher Cost versus conventional scenarios</b>	–	–	<b>24%</b>	<b>52%</b>
<b>Risk Reserve Adjustment (P3 vs. Public overruns, delays, etc.)</b>			82,125	129,807
<b>Life Cycle OPEX Costs*</b>	[see below]	[see below]	161,770	197,197
<b>Financing Costs</b>				
Interest during construction	21,219	28,020	49,253	74,186
Debt service reserve	45,000	45,000	–	–
Other development costs (inc. fees, legal, accounting)	<u>30,569</u>	<u>32,302</u>	–	–
<b>Total Financing Costs</b>	96,788	105,322	49,253	74,186
<b>TOTAL USES OF FUNDS (EXCLUSIVE OF OPEX COSTS FOR P3 CASE)</b>	<b>398,621</b>	<b>523,242</b>	<b>840,650</b>	<b>1,266,568</b>
<b>SOURCES OF FUNDS</b>				
Debt draws	338,828	444,756	840,650	1,266,568
Equity draws	59,793	78,486	–	–
<b>TOTAL SOURCES OF FUNDS</b>	<b>398,621</b>	<b>523,242</b>	<b>840,650</b>	<b>1,266,568</b>

\*Note: Life Cycle OPEX costs capitalized (and thus included in "Total Uses of Funds") for Publicly Funded Best Case and Publicly Funded Backlog scenarios but incurred over the project's life for P3 cases.

	SCENARIOS			
	P3 Lower Cost DBFOM 2015	P3 Higher Cost DBFOM 2015	Publicly Funded Best Case 2015	Publicly Funded Backlog 2025
<b>ANALYSIS</b>				
<b>ANNUAL PAYMENTS</b>				
P3: lease/operating payments				
Public: total debt payments	41,935	53,005	63,850	96,199
<b>NPV OF TOTAL COSTS AT CONSTRUCTION COMPLETION</b>				
P3: lease/operating payments @ 6.48% discount rate (P3 WACC)				
Public: total debt payments @ 6.48% discount rate (P3 WACC)	462,791	584,959	646,468	974,003
<b>Life cycle cost savings for P3 Lower Cost versus conventional scenarios</b>	–	–	28%	52%
<b>Life cycle cost savings for P3 Higher Cost versus conventional scenarios</b>	–	–	10%	40%

#### **P3 DBFOM versus Conventional Public Structures Life Cycle Costs Summary**

	SCENARIOS			
	P3 Lower Cost DBFOM 2015	P3 Higher Cost DBFOM 2015	Publicly Funded Best Case 2015	Publicly Funded Backlog 2025
<b>Life Cycle OPEX Costs (\$ thousands)</b>	140,670	140,670	161,770	197,197

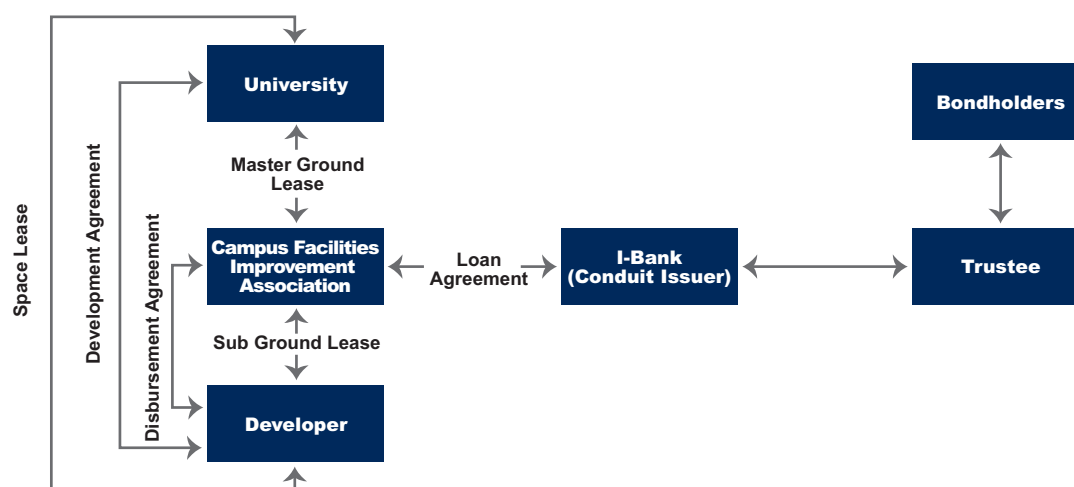
### **UCSF's DBOM Experience with a Private P3 Partner: The Sandler Neurosciences Center**

UCSF has been successful in working with a private partner to develop the Sandler Neurosciences Center. The project utilized a unique structure created by the Board of Regents of the University of California for a lease-leaseback procurement. Specifically, the Design-Build-Operate-Maintain (DBOM) responsibility was shifted to a private partner, Edgemoor McCarthy Cook Partnership LLP, while the financing and ultimate repayment risk was retained by UCSF. This hybrid P3 format (DBOM versus DBFOM) resulted in a less expensive project that was delivered with a much shortened schedule, as compared to comparable procurements for research facilities, including the 50 major VA projects analyzed by the GAO.

In the case of the Sandler Neurosciences Center, UCSF found that the project could be delivered at lower cost primarily because the private partner could build faster and build with standardized design, and because the P3 format could limit or eliminate change orders. It also found that private sector parties can, to a degree, avoid delays and uncertainties common to government processes such as public contracting at lowest bid quotation (typically seen in DBB), which can lead to expensive and adversarial change order processes, lengthy and complex internal reviews that add cost and time, and changes in scope occurring mid-design or during construction that can also cause cost overruns and delays in schedule.

The 237,000 square foot UCSF Sandler Neurosciences Center was budgeted at \$200,000,000, including financing costs, and was delivered on time and on budget. The transaction utilized a structure created by The Board of Regents of the University of California which created a novel lease-leaseback transaction model wherein the design, construction, operations and maintenance risks were transferred to the private partner. Specifically, the Campus Facilities Improvement Association (CFIA), a nonprofit entity, was created as a vehicle to assist UCSF in financing the construction of the building. The CFIA had tax-exempt bonds issued by the California Infrastructure and Economic Development Bank (I-Bank) to cover capital costs. To enable this issuance, The Board of Regents leased the site to CFIA, which sub-leased it to the private developer, Edgemoor McCarthy Cook Partnership LLP, which assumed Design-Build-Operate-Maintain (DBOM) responsibility for the facility. The facility was then leased back to The Board of Regents from the developer for use by UCSF. Pursuant to the terms of the lease, The Board of Regents is unconditionally obligated to make lease payments during the time the bonds are outstanding.

### Lease Leaseback Structure



Source: University of California

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The initial annual rent (for the first 97 months) of \$14,800,000 is inclusive of certain operating expenses. After considering operating costs of \$1,600,000, the net rent to the developer is \$13,200,000, which is equal to a 6.58% net yield on total cost. The developer assigns lease payments made by The Board of Regents/UCSF to the Trustee as security for the payment of the bonds.

The private developer has responsibility for operating the property for the term of the lease, relieving UCSF from operating responsibility. Instead, UCSF pays \$6.75 per square foot adjusted annually, increasing over time, to cover those operating costs. It should be noted that UCSF retains responsibility for security, utilities, and janitorial expenses above the annual operating cost it is paying to the private developer.

The project was built and delivered to the user groups within 24 months, and the total time for project completion was an impressive 50 months from the issuance of the RFQ.

As noted above, in this hybrid P3 format (DBOM), the ultimate financial risk is borne by UCSF. In this sense, the model used for the Sandler Neurosciences Center is different from the classic DBFOM P3 format, where the financing risk is borne by the private partner and the only financial obligation for the public partner is the annual rent or availability payments to the private partner.

## Comparison Cases: The GAO Audit of 50 Major VA Projects

As the auditing arm of Congress, the GAO recently studied 50 major VA projects with budgets of \$10 million or above. For the 23 of those projects experiencing cost increases, the GAO found an average cost overrun of 77%, and for the 24 of those projects experiencing completion delays, the GAO found an average delay of 28.6 months. Four of the largest current VA hospital construction projects (Denver, Las Vegas, Orlando and New Orleans) were studied in detail and showed an average cost overrun of \$366 million and an average construction delay of 35 months.<sup>13</sup> These projects are being built using a DBB project delivery method where virtually all risk is retained by the VA. It should be noted that while the VA largely concurred with the GAO's recommendations, it was not entirely in agreement with its methodology.

A sobering total of over 3,900 projects are currently awaiting funding in the VA's Strategic Capital Investment Planning (SCIP) queue, as reported in the FY 2014 Budget Submission; within this group, the short list of capital projects deemed major (those in excess of \$10 million) holds 21 approved projects with design and/or construction funding but no final appropriation.<sup>14</sup> VA appropriations delays are projected to result in delays in full funding and completion to as late as the mid 2020s.

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<sup>13</sup> GAO Report. "VA CONSTRUCTION: Additional Actions to Decrease Delays and Lower Costs of Major Medical-Facility Projects." April 2013. <http://www.gao.gov/assets/660/653585.pdf>.

<sup>14</sup> VA Fiscal Year 2014 Budget Submission. "FY 2014 Volume IV – Construction Long Range Capital Plan."

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In its assessment of completion delays, the GAO found delays across 24 of the 50 major projects ranging up to 86 months, with an average delay of 28.6 months; overall, 48% of the projects (some of which are in the early design phase) were found to be delayed. When narrowed down to only the 30 projects complete or under construction, 23 (or 76.6%) were found to have suffered completion delay. The added cost of such delays comes from a concerning array of collateral effects, including increasing construction costs due to inflation; the complication of change orders prompted by changing conditions and technologies; the administrative expense of maintaining partial VA support through the appropriations delay period; and rising maintenance expenditures for the older existing infrastructure. These collateral cost effects are compounded by the aforementioned opportunity cost in potential medical innovation and improved research and healthcare for Veterans. The GAO study of 50 major projects found that for the 23 projects that experienced cost increases, the overruns ranged from 4% to 432%.<sup>15</sup> By contrast, a similar assessment of 42 Canadian projects, largely in healthcare and delivered through the P3 model, found that 31% were delivered ahead of schedule, 17% were delayed, and the balance (52%) were on schedule.<sup>16</sup>

Two of the projects evaluated by the GAO, one in Denver and one in Las Vegas, are hospital projects comparable to the proposed SFVAMC Extension objectives and are reviewed here in greater detail.

- The Denver project was originally conceived as a 1.2 million square foot building shared with the University of Colorado, where efficiencies could be found with common facilities such as operating rooms and radiology labs. The estimated cost for the VA was projected to be in the range of \$185 to \$200 million. However, that concept was set aside in favor of a stand-alone VA hospital. The original project budget for this stand-alone hospital stood at \$568.4 million in October of 2008. Ground breaking took place in August 2009, but construction activity stalled until 2012. With delay, the budget steadily rose until it has now reached an estimated \$1.2 billion for a facility whose completion is now estimated to occur sometime in 2016.
- The Las Vegas project was similarly challenged. This development includes a 790,000 square foot hospital, a 120 bed nursing home care unit, a 20 bed mental health facility, and a 47,000 square foot energy center, for approximately 1 million square feet in total. The original budget rose from \$286 million to \$406 million and then to \$650 million. The hospital broke ground in October 2006 and is now fully operational, but the project took more than 6 years to complete and the final cost is now in excess of \$1 billion.

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<sup>15</sup> GAO Report. "VA CONSTRUCTION: Additional Actions to Decrease Delays and Lower Costs of Major Medical-Facility Projects." April 2013. <http://www.gao.gov/assets/660/653585.pdf>.

<sup>16</sup> The Conference Board of Canada. "Canada as a Global Leader: Delivering Value through Public-Private Partnerships at Home and Abroad." August 2013. [http://www.partnershipsbcc.ca/files-4/documents/conference-board-of-canada\\_canadaemergesp3leader.pdf](http://www.partnershipsbcc.ca/files-4/documents/conference-board-of-canada_canadaemergesp3leader.pdf).

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In both these cases, the DBB nature of the contractual relationship with the contractor meant that the design and construction risks (as well as operation and maintenance risks) were retained by the VA as the project sponsor.

The chief issue in the DBB structure described above is the retention of schedule and construction risk by the public sector partner, which can lead to an adversarial relationship between the sponsor and the sponsor's contractor (chosen through a low-bid selection process), because their interests have not been fully aligned. Specifically, the contractor is incentivized to increase profitability by submitting and negotiating a series of change orders, which can negatively impact the project sponsor's budget and schedule.

In the Sandler Neurosciences Center's DBOM contract between the University and its private partner, by contrast, the design and construction risk were shifted to the private partner. The University developed a very thorough Basis of Design document describing the components of the desired facility and the required minimum functionality of each. The private partner was free to design and build a building which would limit the operating and maintenance expense (because the private partner had also assumed those risks) and meet a budget negotiated between the public and private partners within 6 months after selection of the private partner. Once the final budget and schedule were agreed upon (and became embedded in a separate development agreement), the transfer of risk to the private partner was complete. The private partner then had a delivery date to meet and a cost that the private partner had guaranteed. Under the agreement negotiated between the parties, any overruns (change order risk) would be paid for by the private partner. This incentivized the private partner to manage to the agreed-upon budget. The private partner also had to manage to an agreed-upon schedule, as penalties would be incurred for every day of delay past the agreed-upon project delivery date. All of this forces an alignment of interests between the public and private partners. As was noted earlier, the Sandler Neurosciences Center was delivered on time and at the agreed cost.

## Other Relevant P3 Project Case Studies

### Case Study 1: Kaleida Health, Gates Vascular Institute, SUNY at Buffalo

In the United States, one particularly relevant public-private project is the 500,000 square foot Gates Vascular Institute. Here



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Kaleida Health, a for-profit health insurance entity, partnered with the SUNY at Buffalo, a public university in the State University of New York system, to combine their activities in a facility similar to that envisioned for the proposed SFVAMC Extension. The lower four floors of the building contain 250,000 square feet of emergency department, vascular and neurological operating suites, along with a patient hotel. The upper four floors contain research laboratories, a clinical trial and imaging suite, a biorepository and bioengineering facilities. The fifth floor houses a collaborative center including a biosciences incubator, conference suite and education facility. This project was delivered two years ahead of schedule, with savings of \$20 million over traditional public procurement methods.

The Gates Vascular Institute project was financed with both public and private capital. Specifically, the SUNY at Buffalo had legislation passed in New York State allowing it to create a nonprofit entity to receive public funding for the initiative, bypassing traditional public procurement processes. The nonprofit's funds, along with mostly private funds provided by Kaleida, were used to finance the facility. By linking the healthcare and research activities of the SUNY at Buffalo and Kaleida, the partners are currently saving \$25 million in operating costs per year. It is also estimated that the project will deliver \$65 million per year in much-needed local economic impact for downtown Buffalo.

## Case Study 2:

### Los Angeles County, Governor George Deukmejian Courthouse, Long Beach

The new Long Beach Courthouse provides another P3 social infrastructure case comparable to the proposed SFVAMC Extension. The project was completed in 2013 on budget and on schedule. A preliminary analysis of alternative delivery options supported a P3 approach as offering the best opportunity to finance and complete a public building cost-efficiently and in the timeliest possible manner, cutting 30 months off the construction schedule and putting the 35-year quality performance of the building under a milestone-based contract.

Another key determinant in the selection of DBFOM to develop the Courthouse was the opportunity to free up government debt funding (appropriations) capacity for other much-needed public sector projects. It is noteworthy that in this case, the public partner is under no obligation to pay until the space is available for occupancy, and the private partner will be penalized for any portion of the service fee not justified by its operations and maintenance performance and the ongoing availability of the space for use by the





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public partner. All development, construction, financing and completion risk lies with the private partner, promoting a committed timeline and highly accountable management of all aspects of the project.

A conservative analysis of the financial impact of the DBFOM P3 approach used for the new Long Beach Courthouse showed a \$52 million savings compared to a conventional procurement over the life of the building, against the \$495 million overall project cost. Key considerations in the decision to proceed with the full P3 DBFOM approach included accelerated delivery at a time when deterioration, crowding and malfunction at the existing courthouse were reaching a critical point.

The 531,000 square foot scale of the new Long Beach Courthouse project is comparable to the space requirements of the SFVAMC—a scale considered large enough to attract competitive participation in the international P3 market. A diversity of tenant uses is another parallel; the facility incorporates 461,000 square feet of court space, and the balance is a mix of commercial office space (that could eventually be used for future justice needs) and retail space.

The project is financed through a combination of taxable bank debt and equity and is secured by a pledge to the banks of the private partner's lease. The Superior Court of Los Angeles County is committed to pay an annual performance-based service fee for 35 years. The private partner is accountable for performance not just to the point of occupancy, but also for operations and maintenance performance and the ongoing availability of the space for use by the public partner. Also notable is a lag for debt security purposes of 15 years between the 35-year project agreement and the 50-year lease agreement. If there is a failure on the part of the public partner to make necessary payments, the assumption is that the private partner has as a backstop the ability to release the space to other parties. To do so, substantial retrofitting and transitioning is assumed to be necessary, so the private partner's lease has adequate lag to provide value against that eventuality.

Client and independent review of the experience of the new Long Beach Courthouse indicates that the project has performed well against expectations. Regarding the life cycle value of risk transfer to the private partner, third-party P3 infrastructure review of the Courthouse found that "the estimated difference in the value of risk retained by the state for a traditional vs. a PBI procurement [Performance Based Infrastructure delivery or P3 in which the risk is borne by the private partner] is approximately \$120 million." The same third party review addresses concerns similar to those faced by SFVAMC, regarding the likelihood of a publicly financed project happening at all, positing private finance as the likeliest option on viability alone: "...it appears by no means certain that there is a comparable 'public-sector'

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alternative. In the absence of long-term debt financing, the project would in all likelihood be long delayed if constructed at all.”<sup>17</sup>

With regard to the life cycle considerations of enlisting a private operations and maintenance partner, including the enhanced performance possible through a performance-based contract, the review makes this observation: “In light of the state’s projected poor fiscal and financial condition, it does not appear that building maintenance and repair would be elevated in priority in future budgets....A PBI [P3] procurement on the other hand, would include contractual provisions that required the successful bidder to commit to a schedule of required maintenance and repair over the lifetime of the concession agreement.”<sup>18</sup>

A full review of the Long Beach project by the Office of Court Construction and Management concludes, “The project has surpassed the design and construction progress normally achieved by traditional delivery methods.”<sup>19</sup>

## A Key Challenge Facing SFVAMC: Scoring Methodology

As noted previously, a core challenge in the SFVAMC Extension project is to identify a P3 procurement model that would not be scored as a *capital lease*. Under OMB regulations, capital lease scoring would require the full present value cost of the VA’s leasehold obligation, should it be the primary occupant of the new facility, to be recorded in year one unless a waiver of this requirement could be obtained. The Institute team therefore investigated a model based on an operating lease transaction, which would recognize leasehold payments on an annual basis.

According to OMB circular No. A-11 (2012), an operating lease must meet the following criteria:<sup>20</sup>

- *Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease period.*

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<sup>17</sup> Richard G. Little, AICP. Letter to Clifford W. Ham, Administrative Director of the Courts, December 16, 2009 published by Administrative Office of the Courts in “Governor George Deukmejian Courthouse: An Evaluation of Project Agreement Development, Procurement Process & Performance During Design & Construction.” September 2012. pp 206–207. <http://www.courts.ca.gov/documents/Long-Beach-PBI-evaluation-report-9-14-12.pdf>.

<sup>18</sup> Ibid. p 207.

<sup>19</sup> Administrative Office of the Courts. “Governor George Deukmejian Courthouse: An Evaluation of Project Agreement Development, Procurement Process & Performance During Design & Construction.” September 2012. p 4. <http://www.courts.ca.gov/documents/Long-Beach-PBI-evaluation-report-9-14-12.pdf>.

<sup>20</sup> Executive Office of the President, Office of Management and Budget. Circular No. A-11: Preparation, Submission, and Execution of the Budget. August 2012. p 619. [http://www.whitehouse.gov/sites/default/files/omb/assets/a11\\_current\\_year/a\\_11\\_2012.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/a11_current_year/a_11_2012.pdf).

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- *The lease does not contain a bargain-price purchase option.*
  - *The lease term does not exceed 75 percent of the estimated economic lifetime of the asset.*
  - *The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the inception of the lease.*
  - *The asset is a general purpose asset rather than being for a special purpose of the Government and is not built to unique specification for the Government as lessee.*
  - *There is a private-sector market for the asset.*

Based on the OMB criteria above, it is assumed that a private entity, or Non-Federal Entity in OMB parlance, could build a building and enter into a lease with the federal government, and in so doing would be able to secure an operating lease scoring by OMB for a federal government tenancy in a P3 built project if it meets all six of the above criteria.

OMB Circular No. A-11 goes on to state, however, that “If an agency leases from a public/private partnership that has substantial private participation, the lease will be treated as a capital lease,” even though the six operating lease criteria were satisfied. As noted earlier, capital lease treatment results in the full present value of the lease payments being appropriated up front. There is one exception to this rule which is, “If the Government ground-leases property to a non-Federal party and subsequently leases back the improvements, the lease will not be considered a lease-back from a public/private partnership, as long as the lessor is a totally non-Federal entity. Such lease-backs may be treated as operating leases if they meet the criteria for an operating lease.”<sup>21</sup>

Because the site options described above in the Mission Bay area are all in private or non-Federal ownership, the exception above allowing for operating lease scoring would seemingly not be available, unless the property were initially ground leased by the federal government. If this permitted the land under a long-term ground lease to be judged as virtual federal ownership and thus federal land (due to a 50–75 year ground lease term), then the property could presumably be made available for a P3 transaction where the land is leased back by way of a ground sub-lease to a private partner. The resulting improvements would be then leased back by the VA, along with other tenants, thereby allowing for operating lease scoring.

A collocation with other tenants, where the SFVAMC would be a minority tenant with UCSF and/or private-sector co-tenants taking the balance of the

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<sup>21</sup> Ibid. pp 629–630.

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space, would avoid the creation of a dedicated, single-tenant building for the SFVAMC. This mixed tenant approach to a P3 transaction mirrors the arrangement in the new Long Beach Courthouse P3.

## Additional Needed Authorities

Historically, the VA had been granted Enhanced Use Leasing (EUL) Authority under 38 U.S. Code Sections 8161 et seq., which permitted the VA to enter into leases for up to 75 years as a lessor on land that it owned. However, this capability was allowed to lapse by Congress and expired on December 31, 2011. The VA is still permitted to enter into space leases of up to only 20 years as a lessee. It would be preferable, however, in the case under consideration in this analysis, for the VA to have authority to lease space for a term longer than 20 years. This would enable the least expensive financing and therefore the lowest cost lease payment structure for the VA.

It would also be desirable for the VA to be able to ground-lease and then sub-ground-lease land for the new facility for up to 75 years, thereby allowing for a lease-leaseback transaction with a private partner, such as that used by UCSF for the Sandler Neurosciences Center. This transaction structure should permit an operating lease scoring. The ability to ground-lease and then sub-ground-lease to a private partner, along with a VA space lease, is defined as Augmented Enhanced Use Lease Authority (Augmented EUL Authority) for the purposes of this study.

The granting of Augmented EUL Authority has precedent in authority granted by Congress to the Department of Defense (DOD) in 1998. Under that legislation, each of the Armed Services is permitted to engage private partners to build or renovate base housing. Each of the Service Secretaries is permitted to

- enter into contracts, including long term leases or ground-leases with a private partner "for any period that the Secretary concerned determines appropriate;"<sup>22</sup>
- guarantee loans or make loans directly to a private partner;
- enter into agreements to assure the "rental income derived from rental of such units"<sup>23</sup> for the private partner. (This was apparently done to ensure that, if the base housing allowance of service members proved to be inadequate for amortizing the cost of new construction, then a subsidy by the federal government would be permitted.)

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<sup>22</sup> United States Code. Title 10: ARMED FORCES. SUBCHAPTER IV: ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING. Edition 2012. 10 U.S.C. 2876 – Rental guarantees. <http://www.gpo.gov/fdsys/pkg/USCODE-2012-title10/pdf/USCODE-2012-title10-subtitleA-partIV-chap169-subchapIV-sec2876.pdf>.

<sup>23</sup> Ibid.

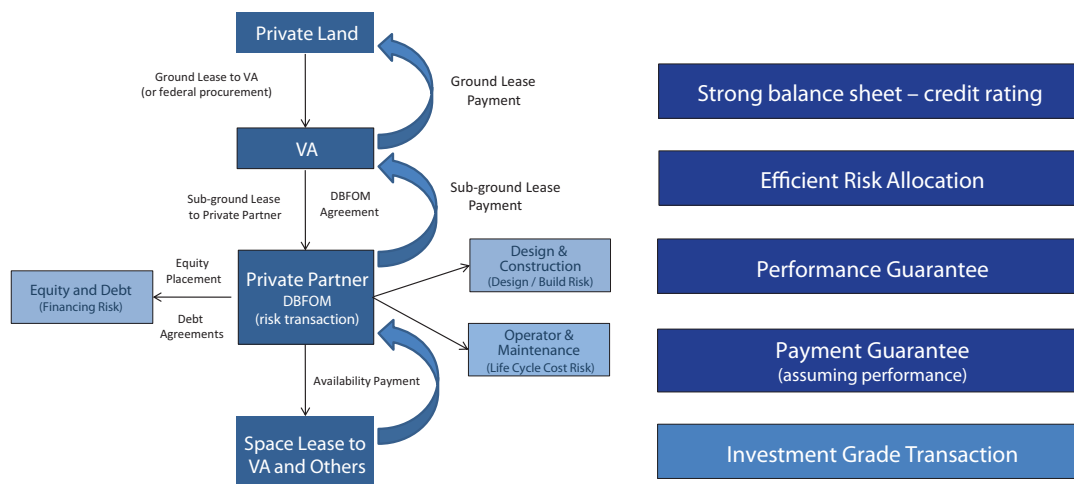
The legislation for a pilot project as proposed in this analysis would need few of the powers conferred on DOD in the 1998 legislation. Rather, the VA would need new authority to enter into a ground lease as a lessee, and then the ability to return to its previously held ability to leaseback (by way of a sub-ground lease—i.e., as a lessor to a private partner for up to 75 years), following which it could enter into a space lease of at least 20 years to occupy the property (although a longer term would enable a lower lease payment). The VA needs new authority (Augmented EUL Authority) to ground lease for up to 75 years as a lessee, so as to qualify the leased property as federal land for the period of the lease, and this will then permit a leaseback transaction to a private partner.

The application of restored EUL Authority to Fort Miley (which is already federal land) would facilitate the engagement of private partners at that site as well, so that buildings there could be repurposed to generate revenue to help underwrite the cost of a new SFVAMC Extension facility in the Mission Bay area.

## Recommended Action

The Bay Area Council Economic Institute recommends that enabling legislation and/or directives be pursued to allow the VA to pilot this P3 DBFOM alternative facilities development model. Those enabling actions would support the proposed SFVAMC Extension in achieving an operating lease classification as opposed to a capital lease classification. Pending legal review by experts in VA procurement and the current conditions around OMB scoring, recommended actions include either a waiver of scoring requirements regarding the capital lease designation or the granting of Augmented Enhanced Use Lease Authority, as summarized above.

## Proposed Structure and Attributes



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To achieve operating lease classification, the following steps are therefore recommended:

- **AUGMENTED ENHANCED USE LEASE AUTHORITY, 75-YEAR GROUND LEASE AS LESSEE**  
On a pilot basis, allow the VA to enter into ground leases of up to 75 years as a lessee.
- **ALLOW 75-YEAR LEASE INTEREST TO QUALIFY SITE AS FEDERAL PROPERTY**  
On a pilot basis, instruct the OMB and the CBO that a ground lease of 75 years on private land qualifies that site to be accepted as federal property for the term.
- **RESTORE LONGER-TERM LEASE AUTHORITY**  
Restore the lapsed Enhanced Use Lease Authority of the VA to enter into a lease (leaseback) of up to 75 years as a lessor.
- **PERMIT A SPACE LEASE TERM OF MORE THAN THE CURRENTLY ALLOWED 20 YEARS**
- **RESTORE ENHANCED USE LEASE AUTHORITY FOR FORT MILEY SITE**  
Grant standard EUL Authority at the Fort Miley site, explicitly allowing the long-term lease of properties to private partners, which will permit the SFVAMC to consider re-use options that could generate revenue to underwrite the cost of occupancy of the proposed SFVAMC Extension facility.
- **WAIVER OF CAPITAL LEASE SCORING REQUIREMENT**  
A possible alternative approach to seeking legislative approval for Augmented Enhanced Use Lease Authority would be to seek, on a pilot basis, the granting an operating lease classification to the SFVAMC P3. This would provide a one-time waiver of the capital lease classification requiring full appropriation of all lease cost in year one and would allow the annual appropriation method associated with the operating lease. Precedent for this approach can be found in the 1988 Thurgood Marshall Building P3 enabling legislation, which permitted a 30-year space lease by the federal government, but was subject to an annual appropriation.

## Conclusion

This analysis was prepared to assess the feasibility of using a private development vehicle to relocate a portion of the SFVAMC's functions currently at Fort Miley to the Mission Bay area in proximity to UCSF. This move is necessitated by the inadequate and in some cases obsolete facilities at Fort Miley and driven by the benefits of close collaboration with UCSF and improved accessibility for Veterans.

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This analysis finds that the proposed project is potentially attractive for private financing and development and is viable as a public-private partnership. With the limited level of capital projects funding currently available to the VA, the present backlog suggests that it may take 10-15 years for the proposed SFVAMC Extension project to achieve funding through traditional appropriations processes, and it is likely under a conventional DBB procurement format to experience significant completion delay and cost overruns.

Without a private partner providing capital and taking on risk, the SFVAMC will be severely challenged to develop and operate the proposed facility in a timely and cost-efficient manner. On the other hand, with the SFVAMC Extension piloting a P3 delivery, the VA is more likely to achieve Secretary Shinseki's stated public-private partnership imperative to "build capacity and create platforms for sharing resources to better serve Veterans, their families, caregivers, Survivors, and beneficiaries."

Because it is not clear how long the few suitable sites identified in the Mission Bay area will be available, time is of the essence. Should this approach be taken, P3 development has the potential to deliver a new SFVAMC Extension facility years ahead of the public procurement, with lower construction cost, greater transparency and accountability, and significant life cycle cost savings as compared to a project strategy dependent on appropriated VA funding using a DBB design and construction methodology.

Failing to overcome the barriers of operating lease scoring for this and future P3 solutions will result in significant opportunity costs for both research and the health of the Veterans community. A successful pilot, on the other hand, can demonstrate the potential of the P3 model to address shortfalls in the VA's larger capital projects program and potentially serve as a model for the national VA system.

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# Appendices

## Appendix A

### P3 Models: An International and Domestic Overview

P3s have been used to tap private capital and expertise for the successful development of a wide range of public infrastructure internationally, with a growing body of P3s deployed in the United States as well. Some international P3 programs are in their third and fourth rounds of full evaluation and refinement after decades of implementation. The VA can therefore draw on what has proven successful and customize what is distinctly applicable to this project's current and particular challenges.

Specifically, the VA can learn from more than 620 projects executed as part of the UK's Public Finance Initiative (PFI) and Canada's successful completion of hundreds of P3s, primarily in the hospital sector. The Canadian government found the innovation, timeline, performance, and cost-efficiency advantages of P3s to be significant enough to issue a federal mandate requiring P3 review for any project over C\$100 million. This mandate led to 38 P3 projects constructed and 24 in the pipeline over the subsequent two year period. Similarly, a recent Infrastructure Partnerships of Australia study forecasts A\$400 billion in infrastructure investment through the decade, with 15% of that designated as P3s providing up to a 30% cost and time delivery advantage. Though the use of P3s in the United States is behind the U.K., Canada and Australia, it is being increasingly utilized in transportation, energy and water and has been implemented for social infrastructure such as military housing and courthouses. As funding constraints impact all levels of government, including federal, state and local agencies that are working to address an aging infrastructure, P3 models can offer a significant alternative.

In the U.S., a number of initiatives incorporating P3 elements have been undertaken, including Chicago's Infrastructure Trust, the Los Angeles Metropolitan Transit District's Measure R projects, and projects under the State of Virginia's Department of Transportation, as well as projects and initiatives in Illinois, Colorado, Texas and elsewhere in California. To date, the use of public-private partnerships at the federal level has been successful but largely limited to military housing and enhanced use leasing under the Department of Defense (DOD), courthouses under the Department of Justice (DOJ), energy projects under the Department of Energy (DOE), and highways and bridges under the Department of Transportation (DOT).

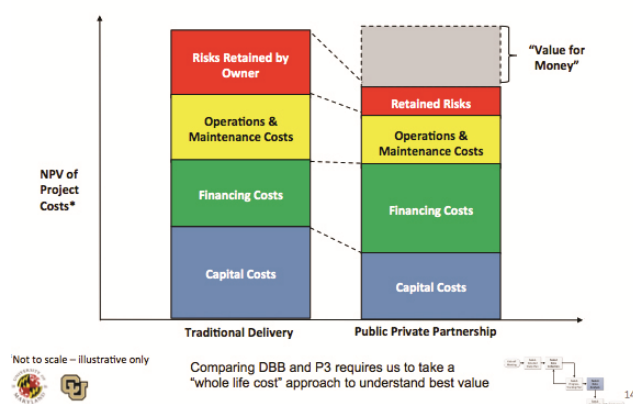


An early example of a federal P3 is the Thurgood Marshall Building in Washington, D.C., where P.L. 99-229 (1988) authorized the Architect of the Capitol to contract for the design and construction of a building on federal land adjacent to Union Station to house the judicial branch and other offices. The Architect was specifically authorized to contract with a private party for the development of those parcels, with all design, development and construction costs borne by the contracted party. The federal government would lease (with the right to sublease) the building, with title to revert to the United States in 30 years. Structural and mechanical care of the facility, however, remained with the federal government.

The DOT, in particular, has been an advocate of P3 and has encouraged its use in delivering new highway and transit projects by making available \$15 billion of private activity bond allocation for P3 transportation projects and providing adjusted criteria to benefit transportation projects in the Transportation Infrastructure Finance and Innovation Act (TIFIA), a federal loan program.

The DOD has actively used P3 models under the Military Housing Privatization Initiative (MHPI), to privatize the operations and redevelopment of nearly 200,000 housing units on or near military bases throughout the country. This program is considered highly successful, having allowed the DOD to deliver increased housing quality and operations for its service members without an increase in scored costs. The DOD has subsequently started to apply the powers granted under EUL legislation to P3 development of other on-base infrastructure, including office buildings, commissaries, and water and power systems.

## Understanding Best Value When Comparing Traditional Delivery and P3



\*NPV=Net Present Value

Source: "A Case Study Comparing Conventional Delivery and Public Private Partnerships" Qingbin Cui, University of Maryland; Keith Molenaar, University of Colorado Boulder; November 13, 2013

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## Appendix B

### Salesforce Mission Bay Property Design Guidelines and Other Site-Specific Considerations

Broad requirements include the following:

- preservation of view corridors;
- maintaining accessible open space;
- increasing architectural interest through the use of color and articulated shapes;
- siting of ground floor retail space so as to activate the street frontage;
- inclusion of public art equal to 1% of construction cost.

The Salesforce land use plan that was approved by the San Francisco Redevelopment Agency had the following provisions:

- 8 buildings on Blocks 26 through 34;
- 5 were not to exceed 90 feet in height and could only have up to 70,000 square foot floor plates;
- 3 were not to exceed 160 feet in height and could only have up to 20,000 square foot floor plans above the sixth floor;
- 2,211 parking spaces were to be provided on a basis of 1 per 1,000 square feet of office space with a further allowance for retail; note that R&D space has a city-wide requirement of 2 parking spaces per 1,000 gross square feet, thus increasing required parking if the proposed SFVAMC Extension facility were to be located at Mission Bay;
- a Town Square—centered in Blocks 29–32—was to be the core public space of the campus and be open to the public;
- the plan allowed for the ability to transfer density from any one Block to any other Block.

Entitlement risk for the Salesforce campus has largely been addressed. The following entitlements are in place:

- The campus was found to be consistent with the goals of the Mission Bay South Redevelopment Project's Redevelopment Plan, adopted in November 1998, and with the Redevelopment Plan Environmental Impact Report.

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- The campus was found to be consistent with the Central Waterfront Plan, adopted by the Planning Commission of San Francisco on September 27, 1990, and other applicable elements of the General Plan.
  - The campus was also found to be consistent with the Preliminary Plan adopted by the San Francisco Planning Commission, Motion 14483, on October 23, 1997.

An SFVAMC presence on some portion of the Salesforce campus will be subject to a change of use process:

- Change of use from office to medical office and biomedical research use can be achieved through the conditional use permitting process. Such a request is likely to be received favorably.
- A change of use analysis from office to medical office and biomedical research use through a Negative Declaration process may be necessary, to determine if additional mitigation may be required for any one of a number of potential environmental impacts such as increased traffic.

The infrastructure (i.e. sewer, storm drain, electricity, etc.) for the area surrounding the Salesforce campus is largely in place:

- The campus is part of an assessment district, as is the entire Mission Bay South Project Area, which ultimately funds the costs of infrastructure to serve the campus.
- The source of debt service for the infrastructure bonds is the captured tax increment created by the Redevelopment Project Area.
- The tax increment also supports affordable housing and public open space.
- SFVAMC would likely be asked to pay an in-lieu fee instead of property tax.

The environmental conditions and geotechnical conditions of the Salesforce site are varied:

- Subsoils consist of fill from the debris of the 1906 earthquake, and underlying this is bay mud which soil engineers often categorize as being a fluid. Because there is a risk of liquefaction, foundations for buildings may require driven or drilled piles, although Blocks 33 and 34 are at a reduced risk.
- The soils in and around the Mission Bay site are managed under a Risk Management Plan which was approved in 1999 by the Regional Water Quality Control Board.
- Blocks 26 and 27 have one Historical Recognized Condition (HRC) which concerns contaminated fill from the late 1800s and early 1900s.

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- Blocks 29–32 have the same HRC as well as a recent Recognized Environmental Condition (REC) which has occurred because of petroleum contamination that migrated northward from maritime fueling pipelines under 16th Street.
  - Five oil companies (the “Pier 64 group”) have been held responsible for the petroleum contamination. Through their project manager, Arcadis, they have removed some of the contaminated soils from Blocks 29–32, and a “No Further Action Letter” was received in 2006 from the Regional Water Quality Control Board. Most of the remaining contaminated soils can be encapsulated on site.
  - However, soils that come to the surface because of pile driving have little value for supporting buildings and therefore will need to be off-hauled to a Class One or Class Two containment facility. Costs may range from \$100–\$150 a cubic yard.
  - Furthermore, when the Salesforce site is developed, mitigation for soil contaminants monitoring will be required.
  - Blocks 33 and 34 have a high rock shelf which may allow for very shallow piles or possibly no piles at all to support foundations. This increases the attractiveness of these sites, and either case will allow for potential cost savings should these Blocks become the location of the proposed SFVAMC Extension. Should Blocks 33 and 34 prove unavailable, then Block 31 could serve as a back-up site within the Salesforce assemblage of blocks.

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## Appendix C

### Financial Model Assumptions

The following assumptions were used to define the scenarios in the comparative analysis:

- The P3 Lower Cost Scenario total capital costs are provided by a private contractor and estimated at \$879 per square foot in 2015 dollars.
- The P3 Higher Cost Scenario, Publicly Funded Procurement Best Case and Publicly Funded Procurement Backlog case total capital costs are derived using VA-based methodology resulting in total capital costs of \$1,217 per square foot, \$1,594 per square foot and \$2,520 per square foot, respectively.
  - To arrive at these numbers, the same combined initial hard cost per square foot amount of \$587 in 2015 dollars (provided by the VA) is used for the three cases—P3 Higher Cost Scenario, Publicly Funded Procurement Best Case and Publicly Funded Procurement Backlog case. Note that the 2015 dollar amount is extrapolated to \$956 in 2025 dollars for the public backlog case, and a 5% annual escalator is applied for years 2015–2025.
    - ◆ For the P3 Higher Cost Scenario, additional soft costs, excluded items and land costs were added to the hard costs, resulting in the total capital cost of \$1,217 per square foot as identified above.
    - ◆ For the Publicly Funded Procurement Best Case and Publicly Funded Procurement Backlog case, a 2.275 multiplier is applied to the hard costs identified above using VA provided methodology and is used to produce total hard and soft costs. Excluded items and land costs (in the same amount as applied for the P3 high scenario) are added to total capital costs. The resulting 2015 total capital costs for the public best case are \$1,594 per square foot as identified above. To arrive at the 2025 capital costs, the 2.275 multiplier is applied to the escalated 2025 hard costs and the excluded items and land costs (in the same amount as applied for the P3 Higher Cost Scenario but escalated at 5% annually to express in 2025 dollars) results in total capital costs of \$2,520 per square foot for the Publicly Funded Procurement Backlog case as identified above.

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- To allow for a direct risk-adjusted comparison, a risk reserve adjustment is applied for both public scenarios to account for costs overruns, delays, etc. that are ultimately borne by the private sector in P3 scenarios; 15% of total capital costs were used as a proxy here for the Publicly Funded Procurement Best Case and the Publicly Funded Procurement Backlog case, respectively.
  - OPEX costs for both P3 scenarios are \$9 per square foot for operations, \$6 per square foot for maintenance, and \$600/unit for parking space O&M. For the Publicly Funded Procurement Best Case, OPEX costs are increased by 15%. For the Publicly Funded Procurement Backlog case, OPEX costs are further extrapolated to 2025 dollars using a 2% inflation rate. Note: OPEX costs are capitalized for both public scenarios to mimic a reserve type fund available to service OPEX costs for the asset's life, allowing for a direct comparison with both P3 cases which incur OPEX costs over the project life.
  - Both P3 scenarios use a 6.5% interest rate during construction and 5.5% for term debt.
  - Both public scenarios use a 4% interest rate during construction and 3% for term debt, reflecting rates applicable for a federal government entity.
  - The bulk of financing costs with the exception of IDC (interest during construction) are not applicable for public models due to appropriations procurement processes.
  - Both P3 cases assume a 15% equity / 85% debt capital structure and a weighted average cost of capital (WACC) of 6.48%.
  - The NPV (Net Present Value) of P3 and public payments uses a 6.48% discount rate which is the WACC of the P3 scenarios.

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## Appendix D

### Local and Regional Economic Impact

Infrastructure and building projects, particularly projects of this magnitude, generate economic benefit for the surrounding area, in this instance, San Francisco and the Bay Area region. These economic benefits include not only the dollars directly spent, but indirect and induced spending, as expenditures flow to supporting businesses, and those dollars are in turn re-spent by their employees on goods and services in the broader economy. This effect is also seen in increased employment and taxes. The development and construction of the proposed SFVAMC Extension project at Mission Bay will, like similar projects, produce an economic ripple effect that will benefit San Francisco and the region.

The Economic Institute estimates that regional economic benefits will total approximately \$545,000,000 in economic output, \$40,000,000 in taxes, and increased employment of approximately 3,000. Additional soft benefits will accrue to San Francisco through the increased synergies coming from a VA presence at Mission Bay, adding to the critical mass and dynamism of the district's growing life sciences community.

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## Appendix E

**Department of  
Veterans Affairs**  
AUG 12 2013

## Memorandum

Date:

From: Secretary (00)

Subj: Guidance for Engaging in Public-Private Partnerships with Non-Governmental Organizations (VAIQ 7381698)

To: Under Secretaries, Assistant Secretaries, and Other Key Officials

1. In today's inter-connected world, the U.S. Department of Veterans Affairs (VA) cannot operate alone. In order to meet VA's fiscal year (FY) 2014-2020 strategic goal to enhance and develop trusted partnerships and address the large scale and complex challenges requiring cross-sector solutions and collaboration, VA engages in public-private partnerships that leverage the full range of our Nation's talent, ingenuity, and commitment to action. These partnerships not only further the Department's mission and priorities, but also build capacity and create platforms for sharing resources to better serve Veterans, their families, caregivers, Survivors, and beneficiaries.

2. It is imperative that VA continue fostering these public-private partnerships, in a responsible and productive manner, and seek out other partnerships opportunities when and where appropriate.

3. Generally speaking, a public-private partnership is a collaborative working relationship between VA and non-governmental organizations (NGO) in which the goals, structure, governance, and roles and responsibilities are mutually determined to deliver the best possible services. Common considerations for engaging in partnerships include advancing a shared objective; enhancing impact by creating resources and expertise; achieving mutual goals to improve and expand services; raising awareness and visibility of programs and services; and developing and implementing appropriate oversight measures.

#### 4. Considerations for Engaging in Public-Private Partnerships

- a. Before engaging in public-private partnerships with NGOs, VA employees should conduct thorough due diligence (vetting) on all potential partners to avoid conflicts of interest, violation of ethics laws, rules, and regulations, or the appearance of a conflict, ensure NGO partners are creditable organizations both programmatically and operationally, and protect the Department's reputation. Due diligence involves those steps taken to evaluate the risks and benefits of engaging in a partnership with a NGO. Where there are existing due diligence processes in place for partners such as those with grantees or contractors, additional due diligence may or may not be required. A list of suggested considerations and available resources to conduct due diligence are located in Attachments A and B. Questions regarding conflict of ethics laws, rules, and regulations should be directed to a VA Office of General Counsel (OGC) Deputy Ethics Official at [GovernmentEthics@va.gov](mailto:GovernmentEthics@va.gov), or to OGC, Staff Group III.



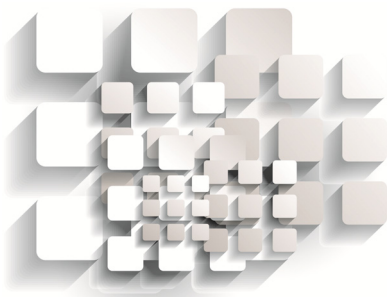
Guidance for Engaging in Public-Private Partnerships with Non-Governmental Organizations

- b. In communicating and collaborating with NGOs, VA employees should be cognizant of the considerations set forth in VA's October 12, 2010, Guidance for Communicating and Collaborating with Industry (see VAIQ 7031603). This memorandum provides additional information relevant to engaging in public-private partnerships. Specific topics referenced include communications with private industry on contracts and procurements; acceptance of gifts and speaking engagement invitations; prohibition of endorsements of products, services, and enterprises except in limited circumstances; and nondisclosure of nonpublic VA information. A summary of issues contained is located in Attachment C.
  - c. All VA employees are subject to the criminal conflict-of-interest laws (18 United States Code Chapter 11) and the "Standards of Ethical Conduct for Employees of the Executive Branch" (5 CFR Part 2635). Employees should comply with these ethics laws while they discuss and/or engage in partnership activities. Every VA employee is required to complete ethics training, which VA offers through the VA Learning University.
  - d. VA should enter into public-private partnerships only after ensuring that they can be conducted in a responsible, productive manner, and after consulting with VA's OGC. OGC should advise the responsible VA official of the appropriate vehicle for the public-private partnership (e.g., memorandum of understanding, contract, or other method of engagement). If a contract is determined to be the best method of establishing the public-private partnership, VA's Office of Acquisition should be engaged with the awareness that any contract awarded will be in accordance with the Federal Acquisition Regulation, the VA Acquisition Regulation, and other agency policies and procedures. VA staff should assess and confirm that the proposed public-private partnership is achievable based on pertinent and valid legal authorities; would comply with any and all applicable competition strictures, appropriations constraints and other laws, codes, and regulations; is formalized through appropriate written documentation and signed by authorized VA officials; and is based upon written documentation containing appropriate business and legal provisions, terms, conditions, and exclusions, including whether the public-private partnership is intended to be a legally binding or non-binding arrangement.
5. Each Administration and Staff Office may provide additional guidance to program and field offices on developing effective and responsible partnerships.
6. If you have specific questions or concerns, please contact Mr. Doug Carmon, Special Assistant to the Secretary for Public-Private Partnerships. He may be reached at (202) 461-4815 or by e-mail at Doug.Carmon@va.gov.



Eric K. Shinseki

Attachments





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