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Dear C.A.S.H. Member:

The Coalition for Adequate School Housing (C.A.S.H.) is aware that some school districts are facing threats of litigation or actual litigation if they choose to use the Education Code section 17406 "Lease-Leaseback" project delivery process.

The C.A.S.H. Legal Advisory Committee has consistently supported school districts' legal use of the Lease-Leaseback process. The Attorney General opined in December 1973 (Opinion No. CV 71-245) that school districts may use Lease-Leaseback. Numerous court decisions also have validated the use of section 17406 by school districts, including a recent June 18 favorable ruling in a Los Alamitos Unified School District validation action.

Attached is a description of Lease-Leaseback delivery from the Association of California Construction Managers (ACCM) Project Delivery Handbook. The ACCM information includes issues that school districts should take into account if they are considering using the Lease-Leaseback project delivery method.

C.A.S.H. hopes this letter helps you as you consider your school district's facility construction and improvement plans. Please be aware though that this letter does not constitute legal advice. All school districts should consult their own legal counsel for an analysis and opinion on the issues contained in this letter.

Sincerely,

David Walrath

## **LEASE-LEASEBACK Chapter 4**

### **A. Description**

The Lease-Leaseback delivery method is to select an organization, commonly referred to as the Developer-Contractor, to develop a new building or improve buildings on property the district owns. A Construction Management firm may serve as a Developer-Contractor. The mechanism is for the Developer-Contractor to simultaneously execute a Site-Lease of the property, giving it the right to develop the project, and a Facilities-Lease, giving it the obligation to develop the project and to lease the improvements and the site back to the district, with the district owning the improvements when the leases expire. Different districts and their attorneys allow different approaches: for financing, if any; for selection of the Developer-Contractor; for design responsibility; for lease terms; and for method of selecting trade contractors. This flexibility is a primary attraction of Lease-Leaseback.

Preconstruction work by the Developer-Contractor up to the time of signing of leases is sometimes conducted under a Preliminary Services Agreement.

Some attorneys draft leases providing for pre-construction services, even design responsibility, with language that calls for an amendment to give approval for construction to proceed including setting the date of completion and the Guaranteed Maximum Price.

### **B. Enabling Legislation**

The statutes, Education Code 17406 for K-12, authorizing this approach are very broad and therefore many variations and different approaches to Lease-Leaseback have been refined. Education Code Section 81335 for Community Colleges is similar to Education Code Section 17406 except for a slight, but significant, language variation. The omitted language “without advertising for bids” is the operative language for Lease-Leaseback under Education Code Section 17406. Pursuant to validation actions taken on behalf of Community Colleges, some courts have held that the language was simply an omission during preparation of the legislation.

As with any construction contract, districts should be certain to consult an attorney experienced with alternative delivery methods to ensure that any proposed Lease-Leaseback agreement meets legal standards.

### **C. Relationship of the Parties**

Parties involved in Lease-Leaseback include the district and the Developer-Contractor. The district's team will include legal counsel, the design team, testing & inspection and potentially an Agency CM representing the district's interest. The Developer-Contractor team includes legal counsel, funding sources, a general contractor and trade contractors. In many cases, the general contractor acts as the Developer-Contractor.

Legal Counsel. Perhaps more than any other delivery method, close coordination with a law firm is critical. Because this delivery method requires at least two contracts: at a minimum, the Site-Lease and the Facility-Lease. In addition, these arrangements also require decisions about the extent or terms of any financing required. An attorney's advice is also necessary to decide whether a validation process is advisable. This a legal proceeding recommended by some attorneys to obtain court approval of the terms of the leases.

Developer-Contractor. Most Lease-Leaseback teams are selected based on qualifications with an agreed upon process to arrive at a Guaranteed Maximum Price. Some districts also consider the lowest cost of the financing, and still others have prequalified a short list of Developer-Contractor teams, and then selected one based on a competition of total project cost.

The legal structure of the Developer-Contractor can vary. Some districts have retained firms who develop private projects as the Developer-Contractor. Many districts retain firms who are general contractors. Some districts have retained Joint-Ventures of teams including Architectural firms. Some firms create a Limited Liability Corporation to hold the leases and subcontract out construction to licensed contractors. Many options are open for selecting the subcontractors and vendors who will work under the Developer-Contractor.

Districts can ask the Developer-Contractor to take the risk of completeness and accuracy of plans. These arrangements are usually met by the Developer-Contractor identifying the risks it accepts and including a contingency or allowance in the Guaranteed Maximum Price for the project.

Architect. The relationship between the Developer-Contractor and the Architect also is important. The Developer-Contractor: (1) can perform design or participate in review and management of design performed by the district's Architect; or (2) develop a price based on design done prior to its selection.

In most Lease-Leaseback arrangements, the district retains its traditional relationship with its Architect. The district and the Architect control the design of the improvements. Many Lease-Leaseback agreements call for the Developer-Contractor to monitor

designs as they are developed to ensure attainment of budget. Almost all Lease-Leaseback arrangements call for the Developer-Contractor to offer cost-saving ideas. Some Lease-Leaseback arrangements call for the Developer-Contractor to take the responsibility to design the improvements.

#### **D. Points for Consideration**

1. A district may use Lease-Leaseback to satisfy its need for financing the project.
2. The district has flexibility on who controls the Architect.
3. The district may participate in selecting not only the Developer-Contractor, but all of the trade contractors and suppliers.
4. Solicitation of trade contractor proposals can create cost savings.
5. Early trade contractor selection can avoid deferred approvals and schedule risk.
6. Developer-Contractors can set Guaranteed Maximum Price very early in a project.
7. Questions continue to exist regarding whether leases can be signed prior to DSA stamp out of plans.
8. Early trade contractor selection provides the owner with earlier project cost certainty.

#### **E. Simple Steps to Implement**

Construction Management services are sometimes requested under the categories of project management or district's representative.

1. Determine whether Lease-Leaseback is the appropriate delivery method for your project.
2. Develop preliminary Lease-Leaseback selection criteria with an understanding of the relative importance of design, construction and financing components of the project.
3. Early trade contractor selection provides a payoff with integrated project delivery and building integration methods.
4. Complete the design, if not already done.
5. Ensure that any title or other land use or contractual limitations on the availability of Lease-Leaseback are researched and understood.
6. Work closely with the attorney you intend to have develop the Preliminary Services Agreement, Site-Lease and Facility-Lease.
7. Develop a Request for Qualifications or Request for Proposal to allow you to select the most appropriate firms for an interview and final selection.
8. Interview appropriate firms.

9. Negotiate with the selected Developer-Contractor the approach to the project: business terms, schedule, and method to set price such as a Guaranteed Maximum Price.
10. Obtain price proposals from subcontractors and vendors, select the trade contractors and vendors, set the Guaranteed Maximum Price or other price, and sign (or amend) the leases and obtain Board approval.
11. Perform the work of the improvements.
12. Commence construction.
13. Complete the lease term payments and procedures of the lease and close the leases.