

PROMOTING PRIVATIZATION  
IN  
COMMONWEALTH COURTHOUSES

by

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**ABSTRACT:**

Privatization is the process of engaging the private sector in whole or in part to provide services traditionally provided by government. The process comes in two primary forms: Load Shedding - representing the complete disengagement by the public sector in the provision of services; and contracting out - the more common form in which government remains vitally involved, but only as a purchaser, facilitator, and monitor, leaving actual provision of services to the private sector.

The focus of this thesis is the potential for savings related to real estate services in state owned courthouses in Massachusetts by contracting out more with the real estate industry. The Suffolk County Courthouse is used as a specific example of a candidate for privatization in this form. Subsequently, a comparison is made between the cost to operate publicly managed courthouses in the Commonwealth and similar privately managed buildings in the Boston area. The method of Turnkey development is also looked at as a way to capture private sector expertise to reduce the cost to procure new and renovated courthouses.

The challenge of privatization is not to convince others of its economic justification. Opposition comes from those who believe the movement will reduce their well-being. Successful privatization of Massachusetts courthouses, and of other facilities, will ride on promoters' handling of opposition.

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For Khooshe

## TABLE OF CONTENTS

INTRODUCTION.....	5
Privatization Focal Points.....	8
Property Management.....	9
Facility Procurement.....	9
The Public Role.....	10
CHAPTER I: Components of a Competitive Environment and the Public Role in Privatization.....	11
Efficiency.....	11
Managing the Competitive Process.....	13
Scope Definition.....	14
Competitive Environment.....	16
Performance Measures and Accountability.....	17
Public Role in Privatization.....	18
Appearance of Privatization.....	18
Agency Mission over Survival.....	20
Increase Talent/Decrease Size.....	21
CHAPTER II: Court Operating Costs, Contracting Out, and Property Management Solutions.....	24
Building Specifics.....	28
Data Overview.....	29
Data Discussion.....	31
- Salaries/Fees/Expenses.....	31
- Utilities.....	35
- Cleaning.....	35
- Security.....	41
Data Summary.....	42
Private Property Management for Courthouses.....	43
CHAPTER III: Increasing Privatization of Capital Projects through Turnkey Development.....	46
Traditional Procurement Methods.....	46
Turnkey Development.....	47
Profit Incentive/Value Engineering.....	48
Limits of Turnkey: No Ownership Incentive.....	49
Dealing with Scope Risk.....	50
Operating Risk Simulates Ownership.....	50
Turnkey Financing.....	52
Finance Options.....	52
Basic Turnkey Structure.....	54
Turnkey in Massachusetts.....	55
Turnkey Summary.....	58
CHAPTER IV: Conclusion.....	59
APPENDICES.....	64
REFERENCES.....	72

## INTRODUCTION:

The Old Suffolk County Courthouse is a beautiful historic building set on top of Beacon Hill next to the Old State House in Boston. It is a proud Victorian structure with grey granite facades and a slate mansard roof trimmed in copper. Upon entering, a visitor is drawn to a large central open space with a vaulted ceiling four stories up and balconies all around. Interior finish materials are mostly stone with murals painted on plaster ceilings above. The building's features project its identity and one senses the tradition of Boston just by being there.

Sadly, the fortress like structure is in a depressing state of repair: the murals are peeling, evidence of water leaks are everywhere, and exposed wiring runs throughout its corridors. For the first time visitor, one wonders how it got this way.

A quick look at the state's fiscal condition is one clue; revenues have not met expenses for over four years causing capital intensive projects like a major courthouse renovation to be postponed. Another contributing factor might be state management of the courthouse. The Boston Globe has published numerous articles attempting to illustrate the "mismanagement

of the Massachusetts court system." <sup>1</sup> Alleged moonlighting by court officers and a lax review of the Globe's allegations by a court administrator has caused many to concur with the newspaper's view that "the entire system of justice will continue to be supervised ineptly." <sup>2</sup>

William Weld was elected Governor on a platform promoting more dependence on the private sector to deliver public services and downsizing of government. His mission was carried by state Treasurer Joseph Malone to the threshold of the Hynes Convention Center, a publicly run facility that has lost money since its inception. After a thorough review of the managing agency, Malone decided to give the Hynes executive director another year to "demonstrate improvement in managing the agency, in improving customer service, and in reducing skyrocketing employee overtime" before deciding to replace the agency with private management. <sup>3</sup>

Some advocates will contend the threat of privatization can do as much as privatization itself to cut costs and promote competition and efficiency. Others argue that privatization is totally counter-productive. One union president was recently quoted in the Globe while commenting on the Governor's policies: "Weld's privatization plan is like a

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<sup>1</sup> Kirk Scharfenberg, ed., "The Courthouse Go-Around," *Boston Globe*, 18 July 1991.

<sup>2</sup> Ibid.

<sup>3</sup> Peter J. Howe, "Malone Gives Hynes a Year to Improve," *Boston Globe*, 18 July 1991.

runaway train filled with people that has just pulled out of the station without a driver, without breaks, and its going at a tremendous speed." <sup>4</sup>

These contemporary anecdotes set the stage for the following privatization discussion. It is a topic debated compassionately from both sides because its affects are far-reaching in a politically oriented state like Massachusetts. Although the tangible benefits of privatization may seem incremental, the movement represents a major transformation of the role of government. Successful privatization will mean a substantial reduction in the size of the public sector. But this reduction should not imply a reduction in capability. Indeed, if government is to successfully manage the process of engaging the public sector to deliver more services, the capacity of its executives must increase.

Many privatization advocates rave about the potential elimination of government from service provision altogether and the benefits that will accrue from less government spending. In reality, the opportunities for complete disengagement, or "load shedding," are limited. This thesis does not presume that courthouses of the Commonwealth can be "sold off" to the private sector as though court facilities of the future could be a competitively leased commodity. Courthouses are unique structures that would lend themselves

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<sup>4</sup> Teresa M. Hanafin, "Suit to Charge Private Rehire of State Health Staff is Illegal," *Boston Globe*, 18 July 1991.

more to the tendencies of monopoly than competition if sold. Furthermore, courts will continue to require financial support from the state. They are not major toll roads or high speed rails to be wholly supported by user fees.

For these reasons, contracting out is the most realistic form of privatization of state courthouses like Suffolk County. Although this may seem the more traditional approach, it implies an intensification of public capacity with respect to real estate management - in short, more punch in a smaller package.

The Suffolk County Courthouse was chosen in particular as medium for this discussion because it serves a symbolic purpose; its condition is depressing, it has been under-funded by a system that promotes deferred maintenance and subsequently avoidable capital improvement expenses, and its management is suspect. Privatization at this courthouse, in the form of contracting for more real estate services from design conception through property management, would represent a new direction for the state - a new attitude of dependence on business and industry to provide services that are only regulated, monitored, and funded by government.

**PRIVATIZATION FOCAL POINTS:**

With state courts, the private sector is already depended upon for many real estate services; new construction, renovation, design, and much maintenance is already done under



contract. But the system could go further. The following areas offer privatization potential in that the state could do more to push contracting deeper into the private sector to gain the efficiencies of competition.

**PROPERTY MANAGEMENT:**

The Office of the Chief Administrative Justice, the office ultimately managing the judiciary's buildings, oversees contracts for a substantial portion of required services like elevator maintenance and equipment repair. Other property management functions such as security, janitorial service, and purchasing are kept in-house and conducted by state and county employees.<sup>5</sup> A comparison will be made between the cost of keeping such services in-house and contracting out to competing entities.

**FACILITY PROCUREMENT:**

Like a traditional owner, the state generally keeps full control over the selection of architects and contractors. There has been experimentation with design/ build, fast-track, and modular construction with prisons and higher education

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<sup>5</sup> For the state buildings analyzed, on site management is provided by the counties. At the end of each fiscal year county managers submit operating costs to the Office of the Chief Administrative Justice for reimbursement on "Schedules of Cost to Service Courthouse Facilities." These schedules provided operating cost data for this report.

facilities which have reduced construction schedules dramatically, and brought national attention to the state's progressive procurement abilities. Chapter III discusses turnkey development as a natural progression of the state's capacity to capitalize on private sector expertise. With this method competing developers are sought out to provide complete proposals covering design, construction, financing, property management, and overall package coordination.

#### THE PUBLIC ROLE:

The inevitable contraction of government through privatization will be neither pleasant nor painless, but it must take place if government is to take advantage of private sector efficiency. But to simply reduce the size of government, without redefining the roles, expectations, and support of those who remain would probably result in a less efficient and more expensive public sector than that which exists today. To upgrade the calibre of the public sector while reducing its size is a more far reaching, productive, and thorough transition than many privatization advocates realize.<sup>6</sup>

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<sup>6</sup> Former DCPO Commissioner, John I. Carlson, Jr. originally brought this issue to my attention and emphasized it in several interviews throughout the course of research.

## CHAPTER I:

### COMPONENTS OF A COMPETITIVE ENVIRONMENT AND THE PUBLIC ROLE IN PRIVATIZATION

A central theme in the privatization movement is that taxpayers will get the most value from their tax dollars by contracting out public services. Fundamentally, any entities seeking the right to produce government services for a fee, including public sector service providers, should compete for that right. Competition is not new to the public sector; the federal government has required that many services be contracted out since the Federal Property Administration Services Act of 1949. Additionally, state government in Massachusetts has contracted out many design, engineering, construction, and maintenance services for decades. This chapter focuses on the essential elements of competitive contracting and suggests a realignment of the state's role in the contracting process.

#### EFFICIENCY: A RESULT OF PROFIT SEEKING MANAGEMENT

Any efficiencies to be gained through contracting out come from the consolidated ownership structure of the private sector.<sup>7</sup> It is the ownership framework, not the people, that

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<sup>7</sup> Most privatization authors emphasize consolidated ownership in the private sector. In particular, Stuart M. Butler, *Privatizing Federal Spending* (New York: Universe Books,

promotes efficiency through the potential for profit. John D. Donahue discusses the elements of efficiency in The Privatization Decision:

When those who control the productive organization are owners (or strictly answerable to owners), the exercise of ownership rights will tend to limit random inefficiency... This tendency of profit-seeking organizations holds true...whether or not contracts are competitive and well enforced.<sup>8</sup>

This pressure to minimize cost and maximize profit inspired by ownership consolidation is the principal element that can result in cost savings to the taxpayer. In Donahue's terms "there is no truly equivalent function in a public bureaucracy, no link in the chain of agency relationships where incentives and authority to press for efficiency are quite so potently concentrated."<sup>9</sup>

In the public sector, ownership is diluted and intangible. Ultimately, taxpayers pay for government services and are the beneficiaries of reduced costs. Technically, they have an ownership interest, but continual taxpayer pressure of government agencies to reduce cost is unlikely because benefits are so remote for the majority of taxpayers. The distance between the citizen funding the service and the civil

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1985), p. 64.

<sup>8</sup> John D. Donahue, *The Privatization Decision* (New York: Basic Books, 1989), p. 90.

<sup>9</sup> Ibid.

servant delivering it is too great and the cost born by each taxpayer too small.

Any natural association of the private owner and the concept of efficiency, however, must be cautioned; first, large "bureaucratic" private enterprises can lose the intense pressure for efficiency between principals and managers just like government.<sup>10</sup> Second, profit seekers will consider use of any revenue that increases cost as undesirable. Subsequently, the social goals often promoted instinctively by government agencies are not necessarily on the profit seeker's agenda.<sup>11</sup> Finally, as Donahue implies in the referenced quotation, well managed profit seekers will pursue cost efficiencies whether or not the contract is well administered and monitored by government. If government is successful in bridling private sector incentives, either low cost of service or high quality will result. If not, efficiency will remain high along with cost to government and profit to contractors.<sup>12</sup>

#### MANAGING THE COMPETITIVE PROCESS:

Simply requiring that government call on the private sector to produce public services is no guarantee of cost reduction. The key factor in the cost of public service is in

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<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

how government agencies promote, regulate, and manage competition.<sup>13</sup>

Establishing such an environment in which true competition can take place is a more challenging task than most realize. The three key components needed to minimize the cost of government services are (i) a clear and concise definition of scope - exactly what the government wishes to buy, (ii) the existence of a competitive environment - one in which numerous equally qualified entities are capable of and eager to provide the defined service, and (iii), a system of measures of accountability - performance standards to which the competitive entity realizes it will be compared and made accountable on a periodic basis.<sup>14</sup> Building and maintaining this environment should be the role of government with regard to its real property needs.

#### SCOPE DEFINITION:

In order to capitalize on a competitive environment, a definition of the scope of work or the product to be purchased is essential. If the product or process is constantly changing it is difficult, if not impossible, to produce a clear definition of exactly what is to be produced by competitors. If the product or process is definable and the results of the

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<sup>13</sup> E. S. Savas, *Privatization* (Chatham, N.J.: Chatham Publishers, 1987), pp. 64-66.

<sup>14</sup> Ibid.

process measurable, it becomes possible to solicit competitive proposals to provide exactly what is called for.

Donahue offers as excellent example of competitive, quantifiable relationships and non-competitive relationships. In The Privatization Decision he contrasts the public tasks of getting the White House painted and providing personal protection for the President.

The building manager responsible for the paint finish on the White House simply wants a high quality finish on the President's residence. He is not interested in how the painter applies the finish, scaffolds the building, whether he hires union or nonunion, or how many days off are given to workers. He simply defines the type of paint he wants, the number of coats, the color, then establishes a contract duration, and invites competition from profit seekers.

Conversely, simply stating that "the President is to be protected by whatever means necessary" could be a very risky form of contracting. Leaving the means of Presidential protection up to an imaginative profit seeking contractor would allow for many questionable tactics. With this government function, Donahue points out that it makes sense to set up a government run organization, with established rules and methods of procedure routinely applied by civil servants.

In summation, if government is to attract and benefit from private service providers it must be able to define exactly what is needed. If scope definition is not possible,

few benefits will accrue from privatization through contracting out.

#### COMPETITIVE ENVIRONMENT:

The second important element in successful contracting of government services is in managing the competitive environment. In selecting from a group of competitive proposals, government must have the ability to determine which providers are most qualified to provide the specified service. If service providers cannot be effectively qualified prior to competing for contracts, government can end up with either an under-qualified contractor not capable of completing the work, or an over-qualified contractor (less common) not particularly interested in a relatively "minor" contract. In either event, government can ultimately pay more than is necessary to resolve problems that would otherwise not arise were service providers pre-qualified.<sup>15</sup>

Exact standards for qualification of contractors are difficult to pinpoint as projects and services vary infinitely. Follow-up on experience levels and reference checking from client lists is usually the central focus of pre-qualification, while the ultimate objective is to establish a very competitive group of contractors equally

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<sup>15</sup> Pre-qualification and contractor certification are essential and formal parts of DCPO's management of competitors. John I. Carlson, Jr. described the process during an interview.



qualified to execute the specific project at hand, all bidding on a well defined scope of work.

#### PERFORMANCE MEASURES AND ACCOUNTABILITY:

The final determinant of cost efficiency gained through contracting out is the government's ability to measure and evaluate the performance of the contractor on a periodic basis and replace him/her if necessary, with minimal transition costs.<sup>16</sup> If a contractor competes for a project or service contract and then cannot be measured in terms of performance or quality, government will fail to capitalize on competitive efficiencies. If product quality is allowed to deteriorate unaccountably, costs will fall for the well managed producer, profits will skyrocket, and savings will not be passed on to the public.

In addition to accountability measures, the public agency must have the ability to remove the contracting party if necessary with minimal costs to initiate another contractor to the product or process. If a contractor knows the public entity will have difficulty in replacing him/her, there is less incentive to maintain product or service quality.<sup>17</sup>

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<sup>16</sup> Transition costs associated with relocating service provision from public to private sector are one of many hidden costs described by Robert W. Bailey, "Uses and Misuses of Privatization" in Steven H. Hanke, ed., *Prospects for Privatization* (New York: Proceedings of the Academy of Political Science, 1987), p. 149.

<sup>17</sup> Carlson interview.

Furthermore, if the agency does not pay attention to the contractor's operations, it will spend significant sums in learning the contractor's means and methods of product delivery during the replacement process. It is essential, then, that government constantly monitor contract performance to both keep tabs on the quality of service and keep up to date on innovative industry techniques and practice.

#### **PUBLIC ROLE IN PRIVATIZATION:**

Successful privatization of more real estate services for the courts will depend on how well the Office of the Chief Administrative Justice and the Department of Capital Planning and Operations (DCPO) can handle the core essentials outlined above.<sup>18</sup> In addition to managing scope, competition, and accountability, three other factors are pertinent to the public role in privatization through contracting: the public appearance of the contract process, the simultaneous development of public managerial talent with reduction in the size of government, and the prioritizing of agency mission over agency existence.<sup>19</sup>

#### **APPEARANCE OF PRIVATIZATION:**

In the contrast illustrated by Donahue of selecting a White House painter and body guards for the President, he

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<sup>18</sup> See Appendix A for an explanation of the DCPO/State Agency relationship.

<sup>19</sup> Carlson interview.

implies that government attention and involvement can be decreased when delivery means are less important than results. Clearly, there is merit in removing paint brushes from the hands of federal workers, but the process and means of providing services for taxpayers will still be important even as public employee participation decreases.<sup>20</sup>

In contracting out construction services for the state, DCPO pays particular attention to both the product it wishes to purchase and the process by which providers of products are selected. Former DCPO Commissioner, John I. Carlson, Jr. stresses the importance of the process of contracting because "anything we do must appear beyond repute." Because DCPO was a product of the Ward Commission of 1980, an investigation into graft and corruption in the former Bureau of Building Construction, extra attention and care are given to proper appearance and propriety in every phase of proposal solicitation, review, contract award, and administration. As more services are turned over to private entities through privatization, and fewer public sector managers handle greater dollar volumes, the potential for corruption and graft can increase. Subsequently, executives will have to demonstrate an even greater resilience to tendencies of the past.

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<sup>20</sup> Ibid.

#### AGENCY MISSION OVER SURVIVAL:

Sentinel privatization author Stuart M. Butler premises much of his argument for load shedding in Privatizing Federal Spending on the fact that as long as government has any role in service provision, there will continue to be pressure for increased spending. With the courts, load shedding is not a realistic scenario as described previously. Subsequently, one can assume traditional political pressure for spending will continue irrespective of employment concentration in either sector. The question is how to resist this natural tendency.

Fortunately, there are examples in Massachusetts where this bureaucratic rule of self-preservation does not apply. DCPO has demonstrated the ability to take on a capital improvement mission from the state legislature, build up its capacity to execute the mission, then **downsize** and disband upon completion of its task. This trait has been demonstrated by its inter agency Corrections Unit which carried out the Governor's mandate to solve the prison bed shortage in the late eighties. The Corrections Unit increased personnel from 0 to 60 between 1986 and 1989, oversaw design and construction of new facilities, and has recently downsized to 15 persons and been absorbed into another department within DCPO. The Courts Unit, another DCPO inter agency group, is in the process of executing its court capital improvement program and will eventually downsize when its more long term mission is complete. Through sound leadership and public service

commitment, DCPO has demonstrated its ability to value mission over bureaucratic self-preservation. This characteristic exemplifies public sector agencies prepared for privatization.

#### INCREASE TALENT/DECREASE SIZE:

In order to meet the challenges of privatization through contracting out, the state would be well served to strengthen its ranks with more highly qualified facilitators of services. In a powerful article called "Public Management of Privatization," Ronald C. Moe referenced a quote by Terry Culler, a former Associate Director of the Office of Personnel Management during the Reagan administration, stating that [the government] "should be content to hire competent people, not the best and most talented people...we should only seek a sufficient work force to perform routine tasks [and that] the best and the brightest ought to be steered to the private sector where the national wealth is really created."<sup>21</sup> Moe hardly agreed with Culler's argument, but he did note an exodus of top talent from the public sector recently. Most are attracted to better salaries and working conditions in the private sector. As the size of government changes, addressing these issues with the right managers might be a prudent agenda item. Certainly, if government is to handle the challenge of

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<sup>21</sup> Ronald C. Moe, "Public Management of Privatization," *Privatization Review*, Summer 1989.

managing private sector relationships, more capable and aggressive personnel will be a prerequisite.<sup>22</sup>

At the opposite end of the equation are public sector employees threatened by privatization. Clearly, the process of contracting out results in a reduced need for civil servants. A critical part of the process must be management of this transition. Several methods have been implemented including requiring the successful contractor to give first refusal to public employees for new jobs under a contract, allowing public employees to form a separate company and bid for contracts, and instituting a "no layoff" policy.<sup>23</sup>

Debatably, this transition is the most challenging and difficult obstacle in the process, but the most fundamental component of cost savings to the taxpayer. To the civil servant's benefit, privatization does not necessarily mean an elimination of jobs altogether from the economy. As government turns to privatization through contracting, new jobs are created in the private sector. The jobs that are permanently eliminated should be those that represent inefficiency and unnecessary cost to the taxpayer. As painful as this may be in the short term for some, the long run

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<sup>22</sup> Ibid.

<sup>23</sup> These techniques were discussed with Michael Lipof, private sector member of the newly created Asset Management Board, the state's new entity to assist in redevelopment and disposition of state assets.

improvement in the economic environment should benefit everyone.

## CHAPTER II:

### COURT OPERATING COSTS, CONTRACTING OUT, AND PROPERTY MANAGEMENT SOLUTIONS

The intent of this chapter is to compare public and private sector operating costs and management techniques and to project savings available to the taxpayer by privatizing more of the property management function in state owned court facilities. The belief is that contracting methods used by private property managers can save taxpayer dollars by encouraging more competition for public real estate services and separating economic issues from the social and political components of the public contracting process.

Originally, the medium for this comparison was a collection of three state owned courthouses, a federally owned courthouse, and a new privately owned and operated downtown office building. State buildings were the Suffolk County Courthouse in Boston, Middlesex Superior Court in East Cambridge, and the Hampden County Hall of Justice in Springfield. The federal building was the McCormack Federal Court and Post Office and 250 Freemont Street<sup>24</sup> was the private office building.

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<sup>24</sup> 250 Freemont is a fictitious name. At the owner's request, the building's identity will remain anonymous. Other information has also been modified, but operating data is actual.



Upon inspection of the five properties, the diversity in building age, design, and function might lead one to question the choices for comparison. Two are sixty to one hundred years old (Suffolk County and McCormack) while 250 Freemont is brand new. Naturally, building systems are dramatically different, and not all buildings house court operations which are characterized by heavy traffic from a variety of users.

There were three reasons for selecting this group for analysis. First, it seemed important to acquire operating data on the older Suffolk County Facility as a bench-mark from which operating cost savings could be measured once the building was renovated. Unfortunately, costs for the courthouse were not made available. The Office of the Chief Administrative Justice has been under public scrutiny for some time and would not release operating data freely. Consequently, assumptions must be made about potential savings based on real costs gathered from other large court facilities.

Second, the fact that Hampden and Middlesex county courts were similar structures in many ways to 250 Freemont made comparisons more meaningful and offered sound medium through which to compare public and private sector property management.

Finally, the varying quantities of work contracted out between the buildings was significant. The county operated properties have many in-house custodial crews, security

guards, painters, carpenters, and maintenance personnel, while 250 Freemont contracts out all of its cleaning, security, and the less technical portions of its maintenance program.

To bolster the point that competitive contracting can reduce cost, the federally owned and operated McCormack Building was added as the fourth comparative property. It offered the perspective of a public building in which almost all services are purchased from the private sector. Although the building is considered outdated by the General Services Administration (GSA) its costs were significantly less than those of the state which operates in more modern facilities.

In addition to the four buildings analyzed, statistics from the Building Owners and Managers Association (BOMA) are included for comparative purposes. The data is taken from a 1990 BOMA survey of between 44 and 55 office buildings (depending on the cost category) in Boston, averaging 230,000 SF and ranging in age anywhere from new to 102 years. The BOMA survey supports the two conclusions that (i) more contracting can lead to lower costs and (ii) the private sector is spending less on facility operation.

The following table compares the varying amounts of in-house payroll against goods and services contracted out or purchased for all buildings:

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TABLE I:

1990 Percentage of Annual Operating Cost  
in Payroll, Contracts or Purchases

<u>Building:</u>	<u>Payroll:</u>	<u>Contracts/Purchases:</u>
Freemont	11%	89%
McCormack	20%	80%
BOMA	26%	74%
Middlesex	62%	38%
Hall of Just.	67%	33%

Note: See Appendix B for explanation of data assembly.

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One final clarification in these comparisons is that 250 Freemont was chosen deliberately because its costs should be higher. It is an image oriented building in which tenant cleaning standards, for instance, are very high; elevator cabs are vacuumed three times per day, finger prints are wiped off telephones and file cabinets nightly, and ceiling diffuser outlets and adjacent ceiling tiles are cleaned every six months.

By selecting a private sector building with high standards for comparison, particularly with regard to cleaning services, the risk that differences in property management scope unfairly favor the private sector should be minimized. By deliberately selecting a private sector building with more comprehensive tenant services, the point can be made conservatively that competition for definable and quantifiable

services will result in a superior product at a much lower cost per square foot than the state presently pays.

#### **BUILDING SPECIFICS:**

##### **Middlesex Superior Court, State Owned**

Completed in 1975, this building has 16 floors of courtroom and support offices and three basement levels totaling 484,660 sf. A state sponsored engineering survey in 1980 determined the building to have "modern systems design and good equipment [that] result in [a] good overall ability to maintain comfort in most areas and provide good electric, elevator, and other building services." <sup>25</sup> The building is state owned, but management is by Middlesex County employees.

##### **Hampden County Hall of Justice, State Owned**

Completed in 1976, this facility has five floors totalling 226,863 sf. Building systems were also surveyed and summarized in 1980 as "nearly new... well maintained with adequate capacity...good provision for comfort control and life safety." <sup>26</sup> Management of this facility is by Hampden county employees.

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<sup>25</sup> Massachusetts, *Report on Present and Future Space and Building of the Judicial Branch*, 1980, p. 126.

<sup>26</sup> *Ibid.*, p. 84.

### **The McCormack Building, Federally Owned**

The McCormack Building is a much older facility, built in 1932, with 21 floors totalling 498,000 sf. The systems are so outdated that GSA considers the building obsolete and has already purchased land and selected an architect for a new courthouse on a waterfront site in Boston.

### **250 Freemont Street, Privately Owned**

250 Freemont was completed in 1989 and is a "state of the art," investment grade office building. It has approximately 650,000 sf over 20 floors and was selected for comparison purposes because its manager practices the principles of successful contracting as outlined in Chapter I. With operations nearly 90% contracted out, its costs represent a reasonably close approximation of future costs to operate a fully renovated, similar sized space such as the Suffolk County Courthouse. In all probability, operating costs for the renovated court will be less than those of 250 Freemont Street given the more modest level of tenant service necessary for a courthouse.

### **DATA OVERVIEW:**

There are great dissimilarities in reporting methods between the public and private sector. Consequently, it is not possible to draw concrete conclusions about potential cost savings on all operations. Operating costs reported by

Hampden and Middlesex Counties, for instance, are reported to the state's Office of the Chief Administrative Justice for reimbursement as lump sums which include several court buildings. Therefore, the square foot costs for repairs and maintenance are derived by dividing the total cost for all county buildings by total county square footage. (See Appendix C for more detail). Given that the level of general repair, systems modernization, and wear and tear can vary drastically across a county's court facilities, it would be dangerous to process and interpret the costs reported by the counties too aggressively in some categories. Since what is represented by the data is not always clear, only probable conclusions can be drawn.

In other categories, the information is clear enough to draw at least one conclusion: potential savings could be realized by contracting out custodial services in the state owned public sector buildings studied. At the state courthouses cleaning costs ranged from \$.67 - 1.01/sf more than at 250 Freemont. If cost differentials between buildings could be applied to the renovated Suffolk County Courthouse, contracting out custodial service alone could generate savings of between \$350,000 and \$770,500 annually.<sup>27</sup>

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<sup>27</sup> Total square footage on the New and Old Suffolk County Courthouses (buildings are connected) is 770,500 based on the "Ten Year Court Facilities Capital Program," a report published by DCPO's Court Facilities Unit. Estimated savings were projected over the building to get the total sum.

Additionally, it is a reasonable hypothesis that other savings are available by subjecting practically all real estate services to competition. Total operating costs ranged from \$7.71 - 12.77/sf.

**TABLE II:**

**The Data: 1990 Costs per Square Foot**

<u>Cat.</u>	<u>Description</u>	<u>Midsx</u>	<u>HOJ</u>	<u>McCor</u>	<u>Free</u>	<u>BOMA</u>
10	Sal/Fees/Exp	1.66	1.60	1.50*	2.48	1.56**
11	Cleaning	2.44	2.64	1.84	1.63	1.31
12	Utilities	2.78	2.09	2.16	2.48	1.98
13	Rep/Maint/Sup	3.43	1.76	1.34	.86	1.88
14	Security	2.14	2.14	.46	.44	.58
15	<u>Insurance</u>	<u>.32</u>	<u>.26</u>	<u>.27*</u>	<u>.13</u>	<u>.27*</u>
	Total	12.77	10.49	7.57	8.02	7.71**

Note: See Appendix C for an explanation of data assembly.  
 \* Estimated costs: McCormack is self-insured. McCormack Category 10 costs were reported at .92 but were 1.32 only last year. Therefore, 1.50/sf is used as a reasonable estimate. BOMA did not break out insurance from its fixed cost category.  
 \*\* This column does not sum because building types and quantities differ in each category. The average total operating cost for 51 buildings is 7.71, which includes .50/sf added to the reported BOMA cost of 1.06/sf for manag. fees.

**DATA DISCUSSION:**

**SALARIES/FEES/EXPENSES**

Salary, fee, and management expense data proved difficult to compare across buildings and between the public and private sectors. Normally, this category would include management salaries, management fees, and office expenses. At 250 Fremont, the \$2.48/sf cost included a management fee of \$1.08/sf. Many of the BOMA buildings surveyed did not; a BOMA

research specialist noted that managers are often reluctant to report fees for large surveys. Subsequently, a \$.50/sf management fee was added to BOMA's reported category 10 cost of \$1.06/sf to estimate for managers not reporting fees. Even with this addition, BOMA figures remain very competitive overall with the public buildings.

Another cause for confusion is allocation of personnel costs. While one building considers a plant engineer a management expense, for instance, another might charge his/her salary to maintenance and repair. Similarly, office expenses get confused with maintenance and repair supplies between the public and private sector.

#### **State Level**

At the state level, a portion of reported salaries are estimated which adds uncertainty. At Middlesex Superior and the Hall of Justice 37% and 21% of costs applied to this category respectively came from the county commissioner's and treasurer's office for administrative expenses. These costs were simply a percentage of total office costs - 25% for Hampden and 21.3% for Middlesex. There was no evidence of a systematic allocation of cost by time card or job description, which leads one to presume that the costs charged may be somewhat arbitrary.



### **Federal Level**

At the McCormack building, wages, salaries, and expenses were actually reported at \$.92/sf. This represents a substantial drop over the past year due in part to a regional consolidation. The Boston GSA office, until 1989, was the central real estate office for New England but is now under the New York central office, which covers the entire Northeast. Last year McCormack costs were \$1.32/sf and have not been as low as \$.92/sf since 1984.

### **Private Level**

Two components of salary and wage costs at 250 Freemont are of interest: Management fees are included here along with rent charges for office space occupied by management within the building. Similar charges do not appear in either state or GSA accounting. At 250 Freemont, these expenses made up 48% of category 10. Still, Freemont management operates the facility with these additional charges included for less than it costs the state.

With additional research, the data could certainly be sorted out. But it seems safer and more useful to simply combine costs for category 10 and 13, wages and salaries plus repair, maintenance, and supplies to get a lump sum for these costs which are otherwise poorly allocated between categories. When combined they appear as follows:

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TABLE III:

1990 Combined Costs per Square Foot for  
Category 10 and 13

	<u>Midsx</u>	<u>HOJ</u>	<u>McCor</u>	<u>Free</u>	<u>BOMA</u>
Sal/Fees/Exp plus Rep/Maint/Sup	5.09	3.36	2.84	3.34	3.44

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The high cost for Middlesex is partly due to an expensive elevator maintenance contract. Middlesex reported a \$1,008,000 contract for 12 elevators (\$84,000/elevator) at the East Cambridge Superior Court, while Hampden county spent \$17,313 to maintain 5 elevators (\$3462/elevator) at the Hall of Justice. Most likely the Middlesex contract was actually a capital improvement that should not be included in operating costs.

The similarity between 250 Freemont and the Hall of Justice at \$3.34 and \$3.36/sf respectively leads one to presume that private sector management fees and salaries can be afforded in a state contract without increasing the cost per square foot over that which the state is currently paying. The BOMA cost in Table III stresses the point that the private sector seems to maintain and collect management fees on a multitude of buildings for a cost equal to or less than that paid by the state.

## UTILITIES:

As shown on Table I, utility costs for all buildings are similar. Utility rates charged are generally the same for both public and private sectors. Differentials are probably a function of fuel selection, preferred comfort zones, and efficiency as a function of building design.

## CLEANING:

### State Level

The data indicates that costs are significantly higher for cleaning services in state owned courthouses. At both the Hall of Justice in Springfield and the Superior Courthouse in East Cambridge janitorial crews are comprised of county employees. Approximately 30% of these workers earn wages that are 46 - 62% greater than comparable private sector union wages in downtown Boston.<sup>28</sup>

Reasons for these excessive costs are straightforward. First, work-rules of public sector custodial unions require that the newest employees are the first to be laid off when budget problems arise. Because of such rules, custodial crews evolve naturally into groups of older workers whose salaries continue to increase with cost of living adjustments.<sup>29</sup> Second, little competitive pressure exists to boost worker

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<sup>28</sup> See Appendix D for data assembly.

<sup>29</sup> Described in an anonymous interview with a Middlesex County Capital Facilities Project Manager.

productivity. Public sector managers do not benefit from the natural incentive for efficiency caused by consolidated, profit-seeking owners. Available data on custodial earnings was developed as follows for 1989 and 1990:

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**TABLE IV:**

**Number of Custodial Workers Earning from \$10,000 - 29,000 per Year**

	<u>Midsx 89</u>	<u>HOJ 90</u>	<u>Free 90</u>
over \$29,000	1	0	1
\$21 - 25,000	15	0	1
\$20 - 21,000	0	6	0
\$15 - 20,000	12	12	3
\$10 - 15,000	6	0	32

Note: Table does not include temporary workers employed at the Hall of Justice. None of these 19 workers earned more than \$7,000 in 1990. Also, detailed earnings data for 1990 is not available at Middlesex. See Appendix C for information.

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On a more positive note, one manager stated that current economic conditions are influencing worker efficiency. Although the political element is always present, "courthouse workers feel the pressure and understand the situation," the manager stated, and positions are filled only after appropriate advertizing and candidate interviews. Notwithstanding efficiency improvements, however, the cost of workers at this level will continue to be a potential source of savings through contracting out.

## Federal Level

Custodial services at the McCormack building are completely contracted out by the GSA to a private company. In comparison to the privately managed Freemont building several contract scope differences explain the cost range from \$1.63 - \$1.84/sf. First, through the Wagner Oday Act the federal government uses the McCormack Building as a training facility for custodial workers with a variety of physical and mental handicaps. The workers are paid more than the minimum wage but less than the standard downtown custodial union wage of between \$6.80 and \$7.15/hr. Second, cleaning at the federal building is done during normal working hours, thereby saving any premium paid for after hours workers. Finally, the actual cleaning specifications call for fewer cleanings per week and longer durations between periodic cleanings in comparison to 250 Freemont. Some of these factors add to custodial costs while others should bring about savings. What is most relevant is that the federal government is carrying out social programs to benefit less fortunate workers, maintaining competition for the right to clean its buildings for a fee, and doing it for \$.60 - .80/sf less than it costs the Commonwealth.

John S. McNaughten, former GSA Director of Real Estate for Region One (New England) and current Project Manager for the new federally owned Fan Pier Courthouse project, is a strong proponent of GSA contracting practices. As regional

director, McNaughten began contracting for facility services in 1973. His in-house staff was reduced over the next ten years from 450 to approximately 80 persons. Shortly after McNaughten began contracting he noticed a substantial accumulation of savings. In the late seventies annual operating costs at the John Fitzgerald Kennedy Federal Office Building in Boston had dropped from \$1 million to \$600,000. All of this was attributed to reduced cleaning costs, McNaughten stated.

At the five year old Thomas P. O'Neill, Jr. Federal Building, also in Boston, cleaning costs were only \$.98/sf in 1989 and all contracted out. Although further research is needed to determine the exact scope of this contract, it is safe to conclude that the federal government spends significantly less than the Commonwealth for similar custodial services.

Federal employees at the GSA are quick to point out, however, that contracting out has not been a panacea for government. Problems noted by federal contracting specialists are numerous: Cumbersome regulations cause time delays in issuing and executing contracts; a multitude of set-aside programs severely constrict the competitiveness of the bidding environment; prevailing wage requirements are set by regional officials who often have insufficient knowledge of local wage levels, causing expensive differentials between prevailing requirements and locally acceptable wages; and the bidders

screening process is often done by Washington officials who often possess little knowledge of the local contracting environment.<sup>30</sup> The major difference between federal contracting and private sector contracting was emphasized by GSA managers: The government has a broader agenda than simple economic justification. Social and political factors get equal attention in its contracting process, and both tend to inhibit the economic benefits brought about by purely competitive contracting.

#### **Private Sector**

Property managers at 250 Freemont put less emphasis on social and political issues in contracting for cleaning services. Although they do educate all building workers on new public transportation programs in Boston and are involved in career orientation programs with local schools, Freemont's managers are primarily interested in the economics of the contract.

The Freemont cleaning contract is based on the contractor's cost plus a fee. All wages and benefits to be paid by Freemont are clearly defined along with exactly what materials will be either provided by the manager or the contractor. Scope of work is also made clear in the custodial request for proposal: The expected levels of cleanliness, the

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<sup>30</sup> These points were emphasized in an interview with a GSA contract specialist who wishes to remain anonymous.

number of times each area is to be cleaned per day, and the procedure by which the contractor's employees clean each space is described in detail. In addition, the manager defines the rates of production expected by the contractor's employees and routinely monitors actual production and quality levels with the contractor's manager. Monitoring of performance is done according to the property manager's defined standards. Copies of inspection reports are included in the request for proposals simply to clarify management expectations and accountability methods.

With GSA specifications the contractor is often required to develop his own reporting techniques for custodial quality control and routine mechanical maintenance. Although simpler for the government in concept, the opportunity for the contractor to establish reporting procedures can only serve to loosen the GSA's grip on accountability and performance.

At 250 Freemont, the property manager is willing to take on the risk of an open ended contract because he\she knows the productive capacity of competitive contractors and has the sophistication to accurately monitor contractor performance. The manager is not committed to involving his/her staff in the production of service offered to tenants. Management of the process of high quality product delivery is the central focus.

The average cost in the BOMA survey of \$1.31/sf again emphasizes potential savings by privatizing cleaning services. Over the 55 buildings for which managers contributed figures,



\$1.31/sf is probably representative of a more realistic cleaning standard. The difference of \$.32/sf below Freemont is indicative of the high level of service in a Class A facility, while the difference of \$1.13 - 1.33/sf over state owned facilities is an "incremental" savings that could pay real dividends if promoted state-wide.

#### SECURITY:

Security is another area where the state retains the ability to delivery public service in-house. Only one manager was questioned about the scope of work represented by the comparatively high costs of \$2.14/sf at both Middlesex Superior and the Hall of Justice against the other buildings. At Middlesex Superior, Charles E. Boyle, Legal Counsel for Middlesex County advised that Court Officers and Corrections Officers providing courtroom and jail security at the superior court are not accounted for in court building expenses sent to the state for reimbursement. The security costs noted in Table II only cover County Police patrolling general public spaces - like lobbies, entrances and corridors and grounds.

The federal courthouse has a contract for security services in similar public spaces for \$.46/sf, 250 Freemont spends \$.44/sf, and BOMA buildings spend \$.58/sf on average. Although additional research is required to confirm scope differentials and the author fully acknowledges the general

difference between courthouse and office building security, it would appear savings of at least \$1.00/sf could be achieved by investigating the system further and introducing competition.

**DATA SUMMARY:**

Scope differential is a serious consideration when comparing operating costs in buildings with different ages and functions. Still, there are similarities in the buildings investigated that allow for meaningful comparisons from which two reasonable conclusions are generated: First, the state is spending substantially more for custodial and security services by using public employees for both production and management of services. Similar operators in both the public and private sector pay approximately \$2.30 - 2.90/sf less for these services when the categories are combined. At the Suffolk County Courthouse, such savings could come to between \$1.5 and \$2 million annually over the 770,500 sf facility. And these savings would be net of management fees paid back to the private sector through contracting. Second, much more of the process of service provision is subjected to competition in the buildings that are less expensive to operate. As the percentage of services provided through in-house employees rises, so does the cost. These facts do not seem coincidental and should warrant additional investigation by advocates seeking to reduce the cost of government.

## PRIVATE PROPERTY MANAGEMENT FOR COURTHOUSES:

A possible recipe for efficient management of a renovated court facility is to hire an established private manager with a fee structure such that there is profit realized to him/her through competitive contracting, while the state retains the ability to define and monitor exactly what it wishes to purchase.

The fee structure could give the private manager a fixed fee on a square foot basis, supplemented by a majority share of savings realized through competition. The savings would have to be calculated from an agreeable operating cost cap set at the beginning of the management contract. And the cap would have to be subject to escalations based on cost increases beyond the control of management such as utility rates, insurance, and tax increases. Offering private property managers the opportunity to profit by reducing prices for services through true competition would be a successful corralling of the fundamental incentives of consolidated ownership. Subsequent shared saving could serve both the private sector and the state.

Another benefit of giving the responsibility for contracting to the private sector is that social and political influences can be separated away from the flow of taxpayer spending for real estate services. For example, it is acknowledged that set-aside programs do promote minority and small business interests, but they also cause inefficiencies

by restricting the quantity of qualified bidders for contracts. Rather than reducing a competitive group of bidders to only minority owned or small businesses, tax credits could be offered to contractors employing and training minorities, or any other group targeted for affirmative action, at a given percentage of their work force. Through tax credits, the state can retain a more competitive environment by contracting more freely and promote social issues concurrently.

The current bifurcated system in which the DCPO manages large capital improvement projects on the one hand, while each state agency, including the judiciary, actually manages its property on the other seems redundant and hardly competitive. DCPO already has a strong facilities management staff which handles many large construction projects and offers management assistance to agency property managers. It presently serves as a central link in the network of property managers between many state agencies. It seems reasonable, then, that DCPO could take on responsibility for hiring private sector property managers and monitoring performance within state owned facilities.

This restructuring could not only add a more competitive element to courthouse management, but it could address the problem of deferred maintenance as well. Presently, the state has a built-in disincentive to properly maintain its real property: capital improvements are funded by general

obligation bond issues, for which principal and interest is paid through DCPO bond funding rather than from agency budgets. Consequently, agencies like the Office of the Chief Administrative Justice have a natural tendency to ignore or defer maintenance, particularly in tight fiscal times, which eventually turns into a capital improvement to be funded elsewhere. This system turns annual gutter cleanings into major roof repairs, and furnace filter changes into furnace replacements. A system consolidation which retains demonstrated expertise and consolidates contracting authority for both capital improvements and property management within DCPO could solve old problems, introduce new competition, and save taxpayer dollars.

## CHAPTER III:

### INCREASING PRIVATIZATION OF CAPITAL PROJECTS THROUGH TURNKEY DEVELOPMENT

This chapter discusses Turnkey development as a form of privatization that could be applied at the Suffolk County Courthouse to reduce the procurement time-frame, simplify public sector problem solving, and reduce total project cost. The only non-housing Turnkey project approved to date is the Massachusetts State Track Facility at Northeastern University.

#### TRADITIONAL PROCUREMENT METHODS:

The traditional form of state facility procurement is for the state to begin with its own parcel of land, select designers and builders through public bidding, raise funding through general obligation bonds, and operate the new facility with in-house management upon completion. There are many advantages to this established method: It is well understood by participants, competitors for different roles in the process are plentiful, the cost of capital is low, and the state is in control.

Along with ultimate control, however, the state bears the majority of risk with this traditional method. By hiring designers it takes ultimate responsibility for cost overruns and coordination between architect, engineer and builder.

When the state hires builders and assigns them to a preselected design team, it must act as coordinator, moderator, and often peacemaker between these entities.

#### **TURNKEY DEVELOPMENT:**

The Turnkey method of development reduces the owner's interactive responsibilities with the various entities in procurement by engaging a private developer to assemble the design, construction, financing, and property management teams and deliver the finished product within a budget and time-frame.

While the state may have to delegate some control over projects in using turnkey, it gains flexibility in that municipal employees do not have to be added to the payroll to execute a project.<sup>31</sup> Additionally, greater private sector participation can remove the project from political influence and control and provides insulation for politicians from responsibility should something go wrong.<sup>32</sup> Also, schedule can be reduced substantially and private sector coordination of design and construction can lower total project cost.

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<sup>31</sup> John W. Presle, *Finance and Service Alternatives for Municipalities* (Grand Rapids, MI: Varnum, Riddering, Schmidt & Howlett, 1988), p. 4. This report is an excellent analysis of pros and cons of traditional procurement, private provision of services, installment contracts, true leases, and lease rental financing.

<sup>32</sup> Ibid.

#### PROFIT INCENTIVE/VALUE ENGINEERING:

The concept of value engineering is central to turnkey. It takes advantage of the developer's experience in coordinating design and construction and his/her desire to profit.

The developer naturally has the profit seeking incentive to produce cost efficient building systems, from HVAC and electrical distribution through structural frame selection and building skin assembly. If the developer does not produce an efficient product, its building will be neither competitive nor profitable in the market place.

This incentive inherently drives the developer but is often lacking when the state develops its own facilities. The state naturally has cost efficiency in mind during procurement, but the nature of this accountability is different from the developer's incentive for profit. With the state, the mission is always to spend as little as possible, but the strongest incentive is to avoid spending more than what is considered "normal" or "appropriate." Conversely, the private developer's primary objective is to bring projects in for less than the competition so profit margins may be increased. Harnessing this private sector energy should be the key objective of turnkey state projects.



## LIMITS OF TURNKEY: NO OWNERSHIP INCENTIVE

The natural problem with turnkey is the ownership interest. When a developer owns and operates a building for profit it takes the long term residual property value and annual operating cost into consideration during value engineering. The potential for undesirable low residual value and high operating cost checks the tendency to simplify construction methods and reduce quality of materials to where the project is cheap to build but expensive to operate. When the developer turns a building over to a permanent owner after construction, his/her "ownership" interest expires with the building's guarantee, typically after a year. This lack of long term responsibility tends to play out in the value engineering process.

John S. McNaughten of the GSA notes this potential as the greatest risk for government in doing turnkey. Without disclosing project identities he commented on "more than one" turnkey building whose floors seemed inadequately flimsy, systems were expensive to operate, and cladding incapable of shedding water. "Too often we were sold a sexy box that's worthless at the end of the lease," stated McNaughten.

Understandably, public officials like McNaughten cannot afford to be burned repeatedly by any innovative service delivery technique. But once the purchaser turns away from turnkey competition, the potential rewards of lower cost with durable, long lasting quality is lost permanently.

#### DEALING WITH SCOPE RISK:

Mitigating the risk of not knowing what is being purchased in a turnkey project, or scope risk, is achievable by the public sector. But it requires a level of expertise in scope definition at least equal to the developer's ability to capitalize on cost efficient means and methods. As long as the developer of turnkey projects has the opportunity to define product scope in proposals, the risk that the purchaser will get less than it perceives to be paying for will be significant. Consequently, before a state agency ventures into turnkey purchasing it is imperative that it builds up an in-house team of specification writers and inspectors to define what is needed and to insure that needs are met.

Definition of project scope would be especially important at Suffolk County as historic renovations traditionally have a multitude of hidden problems that, for practical purposes, do not get addressed until the project is underway. Although much of this renovation risk can be minimized by joint investigation into such areas as structural soundness, or exterior wall and roof condition, all parties would need to agree to a contingency of some magnitude.

#### OPERATING RISK SIMULATES OWNERSHIP INTEREST:

From an external perspective, it is easy to criticize purchasers of turnkey development proposals for falling short in capacity to define project scope. In reality, the

responsibility for specification writing is far more challenging than it appears in retrospect. Aside from the fact that it can be onerously tedious, it is doubly challenging to get everything "right the first time."

To bolster the human element of scope definition, a purchaser of turnkey development services would be well advised to align the developer's interests at the proposal stage as close to those of the ultimate owner as possible. One such strategy is to require the developer to take on operational responsibility for routine maintenance and property upkeep for an extended time period (say five years at least) after project completion.

As an illustration, the developer as property manager would be responsible for the maintenance and repair of all mechanical and electrical components of an HVAC system over a long term management contract. By giving responsibility to the developer for components with relatively short economic life like fans, dampers, motors, coils, and chillers, the developer is encouraged to rigorously scrutinize a supplier's proposals which promotes both developer and owner interests.

By defining the role and responsibility of the developer to be as similar as possible to that of an owner, the state might avoid having to specify details of the project infinitum. If interests are parallel, the developer will propose systems and products with the state's interests in mind.

**TURNKEY FINANCING:**

Developer provided financing throughout the turnkey contract is one of the most attractive elements of the turnkey. In a typical case, the developer provides short term financing secured by the state's commitment to purchase the project upon completion and acceptance. A key feature distinguishing turnkey from traditional procurement is the state's lack of financial involvement until project completion.

When developers carry the finance risk associated with construction delays or poor quality, their attention to detail is enhanced. In a traditional project, in which the independent responsibilities of the owner and architect directly affect project timing and scope, builders' profits are determined more by project execution according to plans and specifications than by schedule. In traditional procurement it is simply too easy to implicate other parties when schedule is a problem. With turnkey, the developer's profits are determined primarily by his/her ability to provide a product meeting the owner's guidelines in the shortest time possible.

**FINANCE OPTIONS:**

In all probability the state would select general obligation bonds to finance the Suffolk County Courthouse. In Massachusetts there are few benefits accrued through lease

rental financing on major capital projects. General obligations offer the lowest cost of funds because they are secured by the full faith and credit of the Commonwealth. Although the state currently has the lowest municipal credit rating in the nation, Moody's Investor Service acknowledges its "strong legal requirements and administrative powers to manage cash."<sup>33</sup> Additionally, the credit rating only provides a benchmark from which other finance vehicles are risk adjusted upward.

The alternative to general obligation bonds is lease rental financing. Municipal lease rental financing is a viable alternative to traditional general obligation bonds but it is new to the state, no quicker to issue, and provides a lower cost only when coupled with tax benefits secured through a "true lease" derived from a sale leaseback. The viability of such a structure draws serious reservations from tax experts and is viewed as a "threading of the tax needle."<sup>34</sup> The risk that the cumbersome structure will fail to generate

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<sup>33</sup> George Leung and Steven Hochman, *Moody's Municipal Credit Report* (New York: Moody's Investor Service, 3 June 1991), p. 1. This report rated a \$567 million Commonwealth general obligation bond issue at Baa.

<sup>34</sup> This comment came during a phone interview with a tax specialist at a local law firm providing bond counsel for the Commonwealth. The discussion centered on IRS classification of a lease rental contract between the state and private sector lessor as a "true lease," which would allow the project to take advantage of tax benefits through depreciation and tax credits (historic only). The problem was the significant risk that the IRS would not accept the developer as the real owner and thereby disallow the benefits.

great savings makes traditional general obligations more attractive.

#### **BASIC TURNKEY STRUCTURE:**

When analyzing the possible privatization of the Suffolk County Courthouse, the state should consider the following steps:

1) The state transfers title to the land and courthouse (or just the courthouse with a nominal lease on the land) to the developer.

2) The state gives assurances to the developer and the developer's lender that it will purchase the improved courthouse upon completion in accordance with state approved plans and specifications and the state's original guidelines.

3) In the current market, the developer's lender could be either a foreign commercial bank providing taxable financing or tax exempt institution like the Massachusetts Industrial Finance Authority (MIFA) which issues tax exempt short term bonds backed by a letter of credit from a commercial bank that would be drawn upon if the bonds were not paid at maturity. This could happen if there were unforeseen construction delays or quality problems keeping the state from accepting the renovated courthouse.

4) The developer builds the project with proceeds from his commercial lender or tax exempt institution. Upon completion and during construction the state inspects project quality to assure guideline compliance. If the project is delayed, the bond issue letter of credit is drawn upon to pay bondholders until completion. After final acceptance the state pays the developer, for the first time, with proceeds from either a general obligation bond issue by the state or a lease rental financing. The lease rental would come in the form of either lease rental bonds or certificates of participation (COPs).

5) The state subsequently services the obligation annually by paying interest on the bonds through the state's capital spending budget or by making lease payments through the judiciary's annual budget.

6) In the proposed scenario, the developer commits to managing the project under a contract as outlined previously simulating long term ownership<sup>35</sup> interest but subject to periodic performance measures.

#### TURNKEY IN MASSACHUSETTS:

Outside of public housing, the Commonwealth's experience with turnkey purchases is limited to a partially approved State Track. This experimentation has been slow to develop due to near obsession in some parts of government with the thought that graft and corruption might leach back into procurement.<sup>36</sup> Due to rigid laws passed under Chapter 579 of the Acts of 1980, DCPO must get legislative approval for every innovative project using either design/build or turnkey.

But although these requirements can slow the process at times, the system has developed the checks and balances required to prudently proceed with progressive techniques.

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<sup>35</sup> These procedures are similar to and guided by those described in a memo to the Governor from the Commissioner of DCPO on February 6, 1991 which discusses the status of the State Track Facility.

<sup>36</sup> Resistance to new procurement techniques has always been initiated by products of the Ward Commission that investigated fraud and abuse in the Bureau of Building Construction in the late seventies. Findings of the commission were embodied in Chapter 579 of the Acts of 1980, which created DCPO to replace the Bureau. Chapter 579 also created the Office of the Inspector General. Interestingly, while DCPO has historically been a promoter of new procurement efforts, the Inspector General has usually opposed anything other than traditional building procedures.

In the Northeastern case, for instance, the Design/Build Selection Board (DBSB) responsible for ranking turnkey proposals, was "particularly intrigued by the architecture of one project and almost made the wrong decision by selecting the most aesthetically attractive proposal which would have cost an extra \$2 million," stated former DCPO Commissioner John I. Carlson, Jr. Concerned with the pressured environment in which DBSB was expected to act, the Commissioner used his ultimate authority to reassess the selection and got support from the board to change the decision in favor of a less expensive project that met all specification guidelines.

The level of professionalism demonstrated in this selection process is indicative of the sober assessment and rigorous analysis applied by DCPO throughout facility procurement. For turnkey procurement alone, the agency has a voluminous manual addressing scope definition, performance standards, the selection process, and expectations of accountability for the developer. Although periodically frustrated with well-intended encumbrances of Chapter 579, DCPO has the capacity to manage the essentials of privatization and should act as central coordinator in contracting out more real estate services.

Given the state's demonstrated ability to manage this challenging process, turnkey allows the private sector to independently propose solutions to thorny problems that can get politically entrenched in public projects. With turnkey,



a developer can take a bundle of issues with which the public sector typically struggles over a twelve to twenty four month period, and propose practical solutions in a much shorter time-frame - six months in Northeastern's case.<sup>37</sup>

If there is a shortcoming in the Commonwealth's turnkey procedures it is that property management is selected separately from the turnkey contract. At Northeastern the state intended to purchase the completed facility from the Beacon Company without retaining the developer's expertise and interest as property manager. As is widely acknowledged, the development industry is rapidly evolving into a broader service industry in which traditionally less emphasized real estate services are far more valued by the provider. As fee-based income becomes more essential to a real estate company's ability to raise capital, property management services play a more important role in company vitality. The state's decision to contract out property management at the track is certainly a step in the right direction in comparison to present court facility management, but a lack of focus on the incentive structure of property management contracts and the missed opportunity to intertwine this function with the developer's value engineering expertise and long term ambitions is unfortunate.

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<sup>37</sup> Carlson Interview.

#### **TURNKEY SUMMARY:**

In the right fiscal environment, turnkey can offer real value by centralizing responsibility for procurement with the developer. Increased dependence on one private sector party allows the state to concentrate on its role as facilitator and solicits private sector solutions to public development problems often encumbered politically. Furthermore, developer provided construction financing increases the state's ability to avoid procurement risk and simplifies bond fund spending plans for the state. The added pressure carried by the developer to coordinate design and construction lets the state take advantage of value engineering expertise and ownership experience.

But the state cannot assume that a simple turnkey contract implies that owner developer interests align. Without true ownership, they naturally do not. A long term property management contract can minimize the risk to the state and revitalize development companies in need of predictable cash flow.

#### CHAPTER IV: CONCLUSION

As the decline in the real estate industry continues and development talent becomes surplus, there will be increased pressure to privatize public facilities. Courthouses in the Commonwealth offer genuine opportunities for privatization and the savings available through contracting out. Generally, these properties have been managed for a long time by the public sector and it is only natural for inefficiencies to creep into any management system when the pressures of profit seeking owners are nonexistent. The honorable mission to serve the public good is certainly an incentive for efficiency, but it will always fall short in capacity to develop innovative techniques to reduce cost when compared to the profit seeking enterprise.

Not surprisingly, operating costs for courthouses reviewed were approximately 30-70% higher than costs for comparable buildings in the private sector. Admittedly, perfect comparisons are difficult, if not impossible, to present but with additional research, accounting differences could be confirmed and cost differences verified. The greatest potential savings are in the custodial and security categories, both of which are produced by in-house employees in the state properties analyzed. These differences conclusively suggest that there are real savings available

through privatization of the management function through contracting.

Although the strongest advocates of privatization suggest that the greatest savings will come from government completely disengaging from involvement in public service delivery, or load shedding, this paper has not presumed this extreme to be applicable to Commonwealth courthouses. Privatization of courthouses has been limited here to the state's contracting out as many services as possible from overall capital facility procurement using turnkey development through property management.

An increased capacity to contract implies a modified role for the state in courthouse procurement and management. Scope definition, management of qualified competitors, and measurement of performance and accountability must be the central focus. The DCPO has already demonstrated its capacity in this regard and should be the focal point of contracting for all capital projects and property management.

Turnkey development of major projects is a technique that allows the state to capitalize on private sector innovation and flexibility. It could be utilized at Suffolk County. Turnkey can put projects together faster, reduce cost through value engineering, separate the state from the risks of coordinating traditional projects, and allow the private sector to help bring about solutions to political problems that often arise in public development.

Whether turnkey is practical today is another issue. Even if annual savings achieved through private property management were much greater than the savings estimated in Chapter II, and turnkey development offered a revolutionary cost savings from traditional procurement methods, the probability of proceeding with such a project would still be low. No matter how great the value, or how ready and willing the private sector may be to offer competitive services, capital projects like Suffolk County must be supported by annual tax revenues. Because a judiciary system cannot stand on its own, as can a highway supported by tolls, it is doubtful that a major project at Suffolk County could proceed before tax revenues begin to rise and the pressure to contain capital spending subsides. Even if creative municipal lease financing could be structured as an "end run" around the legal debt limit, the fiduciary prudence of such a technique is questionable - no matter how the states provides funds for the courthouse, it still has to provide them. And since there does not appear to be a market with a "willingness to pay," as with a toll road, the state should wait until signs of revenue improvement materialize before committing to something like turnkey.

Notwithstanding fiscal problems, the limited potential for turnkey should not be interpreted as an overall indication of privatization prospects. Contracting out property management may be viewed as incremental, but increments of

\$1.5 - 2 million per year at any state run facilities like Suffolk County could add up quickly. And these savings are net of management fees many fear might consume the bulk of added value. Furthermore, savings through property management are available now - there is no need for an improvement in fiscal conditions and the overcapacity of the real estate industry in this area is well known. Finally, DCPO has the expertise to hammer out reasonable deals in which roles and responsibilities are clearly defined, surprises minimized, and benefits accrued to all parties.

Increasing public sector sophistication in purchasing and managing real estate services has been emphasized throughout the paper. The image of the career bureaucrat must change in order to speed development of government executive talent. This fundamental evolution will be at the heart of successful privatization. Better salaries and working conditions are a sure way to accomplish this.

But although privatization can mean lower costs of services to the tax payer and a better regard for more talented public executives, it is a harsh reality for many. Even though instituting rehiring programs for public workers in the private sector can cut away savings on which privatization would capitalize, the need for worker self-esteem and a sense of purpose should not be ignored. In many instances compassion and politics will overpower privatization logic. But as long as citizens see economic prosperity

passing by a region busting with innovative talent and creativity, privatization will be a magnetic movement.

## APPENDIX A

### DCPO/AGENCY RELATIONSHIP:

Real property assets owned by the Commonwealth of Massachusetts are managed by four independent authorities plus the state itself. Massport, the Turnpike Authority, the MBTA, and MWRA all handle such assets as airports and seaports, roads and bridges, public transportation, and water resource and recovery. Because these authorities are so independent, which alone causes capital improvement coordination problems, their management of assets is not addressed here. This is not because they are not good candidates for privatization policies. Indeed, they may offer great potential for taxpayer savings. The state authorities are simply another topic.

All other public buildings such as schools, mental hospitals, prisons, and courthouses are owned by the state and managed through a combined effort of the Department of Capital Planning and Operations (DCPO) and the state agencies that occupy and carry out their mandated functions within the public buildings.

State law requires that user agencies use the expertise of DCPO to evaluate their needs for renovation or expansion of existing space, development, and leasing of new space. When an improvement plan is agreed upon, it is brought to the legislature for approval and appropriation of funds.



Upon approval, the DCPO proceeds with procurement of the project by selecting designers and bidding the project out to private sector contractors through strictly authorized procedures.

Upon completion of the project, the new or renovated facility is turned over to the user agency which both occupies and manages the building. The DCPO does assist agencies through its Facilities Management Office to efficiently manage building operations, but DCPO does not control the property management function per se in public buildings - this is left up to user agencies. All operating costs are paid out of agency budgets with the exception of debt service costs for capital improvements which are funded by DCPO's "parent" office, Administration and Finance.

**END APPENDIX A**

APPENDIX B

TABLE I DATA EXPLANATION:

1990 Percentage of Annual Operating Cost in Payroll, Contracts or Purchases

Percentages were derived by dividing reported in-house payrolls by total costs for each building. See Appendix C for state building information.

	<u>Midsx</u>	<u>HOJ</u>	<u>McCor</u>
Tot. Payroll:	\$3,679,160	1,669,469	676,204
Tot. Oper. Cost:	<u>\$5,922,931</u>	<u>2,379,365</u>	<u>3,457,513</u>
In House:	62%	70%	20%
Contract/Purchase:	38%	30%	80%

	<u>Freemont</u>	<u>BOMA</u>
Tot. Payroll:	\$551,694	423,200
Tot. Oper. Cost:	<u>\$5,144,870</u>	<u>1,658,300</u>
In House:	11%	26%
Contract/Purchase:	89%	74%

END APPENDIX B

## APPENDIX C

This Appendix is an explanation of square foot costs which appear in TABLE II on page 31 for the Middlesex Superior Court and the Hall of Justice. These costs deserve explanation because interpretation of the original data was required before costs could be assemble in the TABLE. Costs for 250 Freemont, McCormack, and BOMA need no explanation as they appear in Table II as reported.

The following are the costs as they appeared in the "Schedules of Costs to Service Courthouse Facilities." These costs are submitted by the counties to the state Office of the Chief Administrative Justice for payment. The counties provide management for the state in state owned courthouses.

As Reported: Middlesex Superior  
1989 Schedule of Costs in 1990 Dollars

Total Costs:					
Category	Redist. Cnty	Midsx Tot:	Midsx * Superior:	Infl.Adj. 4.5%	Cost per sf
Personnel Costs	10..14	4,487,315	2,653,890	2,773,315	5.72
Employee Benefits	10..14	1,733,572	1,025,270	1,071,407	2.21
Equipment:					
Purchased	13,14	107,595	53,711	56,128	0.12
Service Cont	14	26,754	13,356	13,957	0.03
Contractual Serv.	13,14	1,198,562	598,322	625,246	1.29
Rep & Maint/blds	13	114,712	57,264	59,841	0.12
Rep & Maint/land		2,890	1,443	1,508	0.00
Housekeep Supplies	11,14	79,539	39,706	41,493	0.09
Travel	14	17,563	8,768	9,163	0.02
Insurance	15	298,722	149,122	155,832	0.32
Utilities	12	1,471,243	1,289,581	1,347,612	2.78
Other	10,14	65,102	32,498	33,960	0.07
-----					
Superior Total		9,603,569	5,922,931	6,189,463	12.77

Note: excludes capital costs and debt service

As Reported: Hall of Justice  
1990 Schedule of Costs

Total Costs:				
Category	Redist. Cnty	Hampden Tot:	Hall * of Just.	Cost per sf
Personnel Costs	10..14	1,744,174	1,304,380	5.75
Employee Benefits	10..14	526,981	365,089	1.61
Equipment:				
Purchased	14	3,278	2,640	0.01
Service Cont	14	286	231	0.00
Contractual Serv.	11,13	92,257	74,323	0.33
Rep & Maint/blds	11,13,14	67,108	50,025	0.22
Rep & Maint/land		1,970	0	0.00
Housekeep Supplies	11	13,730	11,061	0.05
Travel	14	130	105	0.00
Insurance	15	74,222	59,793	0.26
Utilities	12	589,227	474,681	2.09
Other	13	47,128	37,037	0.16
-----				
HOJ Total		3,160,491	2,379,365	10.49

\* This column is derived in two way: 1) Any costs specifically itemized from the county total as Middlesex Superior or Hall of Justice costs are placed here. 2) The HOJ represents 80.56% of total county courthouse square footage. Therefore, 80.56% of any unitemized costs are charged to HOJ. The Middlesex multiplier is 49.92% with a 4.5% inflator to get 1990 dollars.

Personnel costs and employee benefits are the largest expense for the courts. The costs as provided by the counties needed to be redistributed across other categories to which they pertain. The following tables show the actual employee costs and the new category to which they were assigned for TABLE II:

**Middlesex Superior**

**Redistribution of Personnel Costs  
and Employee Benefits Reported on County  
Schedules of Costs**

Job Descr. Reported	Redist. Category	Annual Earnings	Benefits *	Tot.Cost	Infl.Adj 4.5%	Cost per sf
Admin Ass.	10	134,816	52,417	187,233	195,658	0.40
Tel Oper.	10	80,413	31,265	111,678	116,703	0.24
Syst Manag.	10	107,861	41,937	149,798	156,539	0.32
Cnty Empl.	10	189,841	73,810	263,651	275,515	0.57
Temp. Help	10	16,895	0	16,895	17,655	0.04
Janitors	11	714,170	277,671	991,841	1,036,474	2.14
Supervision	11,13,14	148,407	57,701	206,108	215,383	0.44
Foremen	13	166,180	64,611	230,791	241,177	0.50
Pipe Maint.	13	53,350	20,743	74,093	77,427	0.16
Electricians	13	124,013	48,217	172,230	179,980	0.37
Carp/Mason	13	100,733	39,165	139,898	146,194	0.30
Painters	13	95,998	37,324	133,322	139,321	0.29
Vehic Maint.	13	58,463	22,730	81,193	84,847	0.18
Security	14	662,750	257,679	920,429	961,848	1.98
<b>Middlesex Total</b>		<b>2,653,870</b>	<b>1,025,270</b>	<b>3,679,160</b>	<b>3,844,722</b>	<b>7.93</b>

\* Benefits calculated by:

$$\text{Ann.Earn/Tot.Pers.Costs(ex.temp) * Tot.Emp.Benefits} \\ = [\text{Annual Earnings}/\$4,458,748] * \$1,733,572$$

**Hall of Justice**

Job Descr. Reported	Redist. Category	Annual Earnings	Benefits	Tot.Cost	Cost per sf
Admin Ass.	10	76,292	22,998	99,290	0.44
Tel Oper.	10	68,158	20,546	88,704	0.39
Syst Manag.	10	67,899	20,468	88,367	0.39
Cnty Empl.	10	66,808	8,876	75,684	0.33
Janitors	11	428,746	112,393	541,139	2.39
Supervision	11,13,14	72,920	21,981	94,901	0.42
Mechanics	13	123,988	37,376	161,364	0.71
Carpenters	13	22,880	6,897	29,777	0.13
Painters	13	29,890	9,013	38,903	0.17
Security	14	346,799	104,541	451,340	1.99
<b>HQJ Total</b>		<b>1,304,380</b>	<b>365,089</b>	<b>1,669,469</b>	<b>7.36</b>

Finally, all the costs were redistributed into the categories appearing in the table. The right hand column shows the square foot costs actually shown for the state buildings in TABLE II on page 31:

TABLE II

Redistributed Costs: Middlesex Superior

Cat.	Description	Personnel/ Benefits	Purchase/ Contract	Total Expense	Infl. Adj. 4.5%	Cost per sf
10	Sal/Fee/Exp	187,233 111,678 149,798 263,651 16,895	2,119 8,768 29,349			
	Total 10	729,255	40,236	769,491	804,118	1.66
11	Cleaning	991,841 68,703	30,311 39,706			
	Total 11	1,060,544	70,017	1,130,561	1,181,436	2.44
12	Utilities	0	1,289,581			
	Total 12	0	1,289,581	1,289,581	1,347,612	2.78
13	Rep/Main/Sup	68,703 230,791 74,093 172,230 139,898 133,323 81,192	64,948 568,011 57,264 1,443			
	Total 13	900,230	691,666	1,591,896	1,663,532	3.43
14	Security	920,429 68,702	3,149			
	Total 14	989,131	3,149	992,280	1,036,933	2.14
15	Insurance	0	149,122			
	Total 15	0	149,122	149,122	155,832	0.32
Total Costs		3,679,160	2,243,771	5,922,931	6,189,463	12.77

TABLE II

Redistributed Costs: Hall of Justice

Cat.	Description	Personnel/ Benefits	Purchase/ Contract	Total Expense	Cost per sf
10	Sal/Fee/Exp	99,290	5,237		
		88,704	2,871		
		88,367	1,437		
		75,684	1,327		
			105		
Total 10		352,045	10,977	363,022	1.60
11	Cleaning	541,139	7,941		
		31,634	4,985		
			11,061		
			313		
			1,183		
Total 11		572,773	25,482	598,255	2.64
12	Utilities	0	474,681		
Total 12		0	474,681	474,681	2.09
13	Rep/Main/Sup	31,634	66,382		
		161,364	3,020		
		29,777	5,228		
		38,903	8,009		
			1,651		
			24,369		
			27,053		
	1755				
Total 13		261,678	137,467	399,145	1.76
14	Security	31,633	313		
		451,340	1,183		
Total 14		482,973	1,496	484,469	2.14
15	Insurance	0	59,793		
Total 15		0	59,793	59,793	0.26
Total Costs		1,669,469	709,896	2,379,365	10.49

END APPENDIX C

APPENDIX D

This Appendix explains the wage differential found between county cleaning custodians and downtown union custodial workers.

In the Middlesex County Schedule of Costs, the annual earnings of forty-eight janitors were itemized as working at the Superior Court in an Attachment to the Schedule. Sixteen of the forty-eight janitors (33%) earned over \$20,000 in 1989.

Total Earnings for the 16 janitors:     \$365,985

Assuming a 40 hour work week,  
52 weeks per year, Total Hours:     33,280

$$365,985/33,280 = \$11.00/\text{hr}$$

Union Contract Labor Rate @ 250 Freemont:     \$6.80/hr

$$11.00/6.80 = 1.62$$

or  
62% higher wage

At the Hall of Justice, six of twenty-two janitors (27%) earned over \$20,000 in 1990.

Total Earnings for the 6 janitors:             \$124,014  
Using the same assumptions, Total Hours:       12,480

$$124,014/12,480 = \$9.94/\text{hr}$$

$$9.94/6.80 = 1.46$$

or  
46% higher wage

END APPENDIX D

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