MEMORANDUM

TO: Scott Seacat, Legislative Auditor

FROM: Steve Erb, Senior Performance Auditor

DATE: November 27, 2007

RE: Two Rivers Regional Detention Facility in Hardin, Montana Legislature

As requested, I have acquired a number of documents associated with the funding and construction of the Two Rivers Regional Detention Facility, located in Hardin, Montana. These documents include the following:

- Bond Prospectus
- Trust Indenture (with U.S. Bank National Association)
- Bond Purchase Agreement (with Municipal Capital Markets Group, Inc. and Herbert J. Sims & Co.)
- Facility Operation and Management Agreement (with CiviGenics – Texas, Inc.)
- Feasibility Analysis (completed by GSA, Limited, Durham, NC)
- Standard Form of Agreement Between Owner and Design-Builder – Lump Sum (with Hale-Mills Construction, Houston, TX)

I am providing general background information related to the consortium making the Hardin proposal, problems that have occurred in similar facilities proposed by this consortium, and summary information related to each of these documents. These documents have been provided by the Department of Justice and the Municipal Capital Markets Group. Other information has been gathered through internet research. I have not spoken with officials of the Two Rivers Authority, the City of Hardin, or the Two Rivers Regional Detention Facility.

Background

The Two Rivers Authority was established as the local port authority for the City of Hardin to pursue economic development activities. In April 2006, the Two Rivers Authority entered into an agreement with Municipal Capital Markets Group, Inc. and Herbert J. Sims & Co. to purchase $27,015,000 in Senior Lien Project Revenue Bonds. Proceeds from the bond sale were used to construct the Two Rivers Regional Detention Facility. The facility is a privately designed 464-bed secure detention facility that will be operated and managed for the Two Rivers Authority by CiviGenics – Texas, Inc.

The Municipal Capital Markets Group, Inc. and Herbert J. Sims & Co., in conjunction with a select few builders and private correctional facility operator/managers, has proposed the development of private correctional facilities throughout the United States, primarily in the Texas area. The consortium proposes building regional detention facilities and then using fees to repay facility construction and operating costs.

In the case of the Two Rivers facility, Municipal Capital Markets Group funded a feasibility analysis completed by GSA, Limited to support the detention facility.

Problems at other facilities

The type of privately operated detention facility proposed by this consortium has resulted in problems for other communities in the past. Their proposals assume that the detention facility will generate enough revenues through daily fees charged to jurisdictions for providing secure detention of prisoners. However, there are a number of cases where initial assumptions have been questioned and current revenues are insufficient to cover operating and debt expenses.

We identified three facilities, all located in Texas that were proposed and constructed by this consortium in the past, which have resulted in problems for local authorities. In Hudspeth County, TX, $23.5 million in tax-exempt revenue bonds were issued by the West Texas Detention Facility. The feasibility analysis provided to support the facility, and completed by GSA, Limited, suggested sufficient revenues would be generated to cover debt obligations. Local officials disagreed with this analysis and suggested the county would lose at least $500,000 per year on the facility. According to local residents, a majority of residents of Hudspeth County were unaware that the prison was being financed with revenue bonds.

In La Salle County, TX, the La Salle County Public Facility Detention Corporation issued $21.8 million in taxable revenue bonds to fund a 500 bed private prison. County officials stated the county cannot afford to meet the more than $2 million in debt service on the bonds. In addition, the bonds were issued at 12 percent interest, 6 percent underwriter fees, and a flat rate operation/management contract with a private corporate manager.

In Willacy County, TX, county commissioners issued $50 million in bonds to open a 2,000-bed detention facility. The debt service on this facility is $2.7 million annually and can only be achieved with a 90 percent continuous occupancy rate. The facility was supposed to house illegal immigrants but Homeland Security officials have only agreed to a 2-year contract with the facility. According to local news articles, two county commissioners were convicted of accepting bribes on an earlier detention facility construction project involving the same design/build construction firm as that involved in the Hardin facility. Criminal charges against the prison management company and the construction contractor were later dropped.

Other articles suggest that the consortium has developed a financing method that permits many local governments to avoid debt caps established by most states because the funding is based on revenue generation and is not tied to the local government's taxing authority. Because funding is not provided through general obligations, local populations are generally not required to be informed about the proposed bond issues.

Summary of documents

Bond Prospectus – The bond prospectus clearly states the bonds being issued are revenue bonds and all principal and interest generated by fees charged to house prisoners within the facility will be used to repay costs. The prospectus also clearly states that the Three Rivers Authority does not have the authority or the obligation to levy taxes to repay the bond obligation. Similarly, there is no obligation for the City of Hardin, Big Horn County, or the State of Montana to repay the bonds.

The prospectus requires the facility be built by Hale-Mills Construction and operated by CiviGenics-Texas, Inc. Risks to repayment of the bonds include:

- Future Need
- Occupancy Assumptions
- Inability to sell or lease the project in the event of a default

- Restrictions on prisoner eligibility
- Default remedies might be unenforceable
- Repayment risk
- Damage/destruction of the facility

The prospectus identifies a guaranteed fee to the builder of $19,884,930 and a guaranteed fee to the facility operator of $44.63 per prisoner per day.

Trust Indenture – The trust indenture repeats the caution that all bonds will be repaid through revenues generated by prisoner fees charged to government entities using the facilities.

The trust indenture identifies the repayment schedule for issued bonds and establishes the various accounts to pay operating, maintenance, and repayment costs. Based on information in the indenture, the Two Rivers Authority will have an initial debt service of approx. $211,252 per month beginning in November 2008.

Facility Operation and Management Agreement – This agreement provides the contract between CiviGenics –Texas and the Two Rivers Authority. The initial term of management is 2 years with additional 2-year renewals.

Once 330 prisoners are housed in the facility, the City of Hardin will be paid a business fee license. In addition, once the daily per diem rate exceeds $58.00, the city will receive $1.00 per prisoner per day with an anticipated minimum of $100,000 annually.

Feasibility Analysis – The feasibility analysis was completed by GSA, Limited of Durham, NC. The analysis provides little methodology associated with its determination of potential prisoners to house at the facility. There are a number of assumptions made related to financial viability that appear to be unfounded, to include future incarceration rates, potential improvements to local aviation facilities, and local willingness to incur proposed prisoner per diem rates.

One of the critical concerns in this analysis is the lack of historical data to support anticipated prisoner counts or any defined methodology for determining potential housing levels. This analysis suggests that with an 80 percent capacity (360 daily prisoners) the facility would meet its debt and operating costs. However, without any historical information or methodology, there is no way local officials can validate the analysis with any confidence.