An examination of private financing for correctional and immigration detention facilities

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While governments have traditionally used municipal bonds to finance the construction of correctional facilities, there is evidence that the two major private prison companies, CoreCivic (formerly Corrections Corporation of America, or CCA) and GEO Group, are actively pushing governments to consider the use of private financing to build new facilities, and that governments are increasingly interested in the idea. This focus on building new prison and immigration detention facilities with private financing (known as "public-private partnerships") represents a critical shift in these companies' business model.

The building and acquisition of real estate has become a central growth strategy as both companies became Real Estate Investment Trusts (REITs) in 2013, requiring them to have significant real estate holdings. As REITs, these companies must meet a number of requirements, including deriving a significant majority of their income from real estate activities and distributing the majority of their earnings to shareholders each year. In exchange, these companies are able to avoid corporate-level taxation. For example, GEO Group received almost $44 million in tax benefits in 2017 due its REIT status. Additionally, owning facilities is simply more profitable for the companies than managed-only contracts.

This emphasis on real estate as a business strategy, combined with the current demand for additional jail and prison capacity due to changes in federal immigration and criminal justice policies, as well as states and localities looking to add additional capacity or simply replace aging facilities, makes this sector ripe for private financing of new facility construction through public-private partnership (P3) contracts. Furthermore, with the Trump administration promoting the idea of using private equity to finance other types of infrastructure, such as roads and water systems, it is not surprising to see similar contractual arrangements gaining traction in the corrections and immigration detention infrastructure sector.

In general, we identified contract models that require the company to design, build, and finance the construction of a new facility to the government's specifications. After construction, the company either operates the new facility, or alternatively, the public sector staff operates the facility, and the company provides maintenance. In both these variations, the private company owns the facility, but, unlike with speculative prisons built in the past, they are guaranteed occupancy for the life of the contract.

For example, GEO Group was awarded a contract in 2017 by U.S. Immigration and Customs Enforcement (ICE) for the construction and operation of a new 1,000-bed detention facility in Conroe, Texas. GEO Group is responsible for the design, finance, construction, operation, and maintenance of the facility under a ten-year contract with ICE. The $117 million facility is scheduled for completion in the fourth quarter of 2018. Similarly, in November 2017, the Kansas Department of Corrections (KDOC) awarded a contract to CoreCivic to design, finance, build, and maintain a new facility in Lansing to replace an aging facility. However, unlike the GEO Group contract described above, KDOC will operate the private facility. At the end of the 20-year contract term, the prison will transfer ownership to the state. These examples and others are discussed in greater detail in Section 2 of this report. This private financing boom has serious implications for policy making:

- **Private prison construction deals embed private interests in the criminal justice system, perpetuating mass incarceration.** Private prison contracts can contain perverse incentives to fill as many beds as possible, regardless of whether they include operation. Especially when the corporation finances the construction of a new facility, the government may feel pressure to keep beds filled to justify high-cost lease payments. Some contracts may even explicitly contain bed guarantee clauses. These long-term contracts directly work against efforts to reduce prison populations.
- **Public-private partnerships result in higher financing costs for the public.** When a private entity finances construction, interest rates are usually higher than they would be for municipal bonds because the private entity may not have the same creditworthiness as the government, and their debt is not tax-exempt. While this debt often does not show up on the government's balance sheet as municipal bonds do, the higher cost of financing is passed on to the government through high, contractually obligated lease payments.
- **Public-private partnerships limit the government's flexibility to respond to changing correctional needs.** Given that public-private partnerships can last for decades, it is inevitable that a government's correctional needs will change during the life of the contract. However, these deals severely limit what a government can do to respond to shifting correctional needs.
- **The private prison corporation may not properly maintain the facility.** Regular facilty maintenance is crucial to ensuring healthy and safe day-to-day conditions for both prisoners and staff. However, there is reason to be cautious about CoreCivic's and GEO Group's commitments to high-quality facility maintenance, as discussed in Section 3.
- **Public-private partnerships may decrease opportunities for public and stakeholder input.** Since these deals hand over the entire responsibility for design, construction, finance, and maintenance to one company, and bundle these project phases into one contract, opportunities for public and stakeholder input may be limited or even non-existent.
- **Private prison construction deals prop up companies with records of human rights abuses.** Regardless of whether a new facility will be operated by private or public sector staff, these deals grow and strengthen CoreCivic and GEO Group, both of which have extensive records of human rights abuses.

This report explores the potential increase in U.S. governmental entities utilizing private financing through public-private partnerships to build new correctional facilities. The first section discusses the reasons why we anticipate an increase in public-private partnerships for new facility construction, with a focus on what the companies stand to gain in these arrangements. The second section discusses the different types of contractual arrangements and provides examples to illustrate how these arrangements work. The third section details the serious risks and consequences of these contracts.

Section 1: Anticipated increase in public-private partnerships for new facility construction

We anticipate an increase in localities and states using public-private partnerships to build new correctional and detention facilities for several important reasons, each of which is explained below:

- The two main companies involved in these arrangements, CoreCivic and Geo Group, have indicated that private financing of new facilities is a major focus for them.
- The companies are dependent on owning real estate in order to maintain their real estate investment trust (REIT) status.
- Fully financing new facility construction allows the companies to own facilities, which gives the companies more flexibility in offering different types of contracts to meet differing political environments in a range of localities, states, and federal government agencies.
- Owned facilities provide the companies with revenues and profits from lease payments in addition to operations and maintenance contract payments. Managed-only contracts are less profitable for the companies.

The companies have indicated in their investor materials that private financing of new facilities is an important focus.

The two largest private prison companies, CoreCivic and GEO Group, have indicated in their investor-related documents and calls that they view public-private partnerships to construct new facilities as an increasingly important aspect of their business. On its website, CoreCivic boasts of its "full-service real estate group" that was rebranded as CoreCivic Properties in the company's 2016 rebranding effort.[1] Likewise, GEO Group describes itself as a "national leader in the finance, design, construction and management of correctional, detention and community reentry facilities."[2]

Through the companies' recent talks and presentations, we see in their own words that building new facilities and owning the resulting real estate is an important new focus and business strategy.

As CoreCivic's Chief Executive Officer (CEO), Damon Hininger, explained in their first quarter 2017 investor call, promoting new real estate solutions is an important part of their work:[3]

We continue to see meaningful progress promoting new real estate solutions offered by CoreCivic properties with more states considering a privately financed solution to address their aging prison infrastructure. In the last few months five states have publicly disclosed that they are considering their public private partnership approach to replace outdated prison capacity that would result in the long term lease of the new real estate solutions from the private sector.

At the June 2017 National Association of REITs conference, Hininger echoed these thoughts again:[4]

The second offering that we've really started to work on the next couple of years is CoreCivic Properties, which is really more of a true REIT solution, where we go in provide a real estate to a federal, state, or local jurisdiction primarily in the criminal justice arena where we can potentially either build a new facility to deal with overcrowding or replace a facility that's been in their system that's old and antiquated and needs to be replaced.

Hininger goes on to explain that this emphasis on financing the building of new facilities is "the newest part of our business and our focus over the next few years…"

In CoreCivic's latest investor call in May 2018, Hininger again confirmed that public-private partnerships are an important business opportunity for the company:[5]

In fact, we are in active discussions with numerous states as well as local governments, who are seeking and looking at similar public-private partnership solutions for their criminal justice infrastructure needs.

Similarly, GEO Group's CEO, George Zoley, echoed these opportunities to build new facilities in the company's first quarter 2017 investor call:[6]

There are several states, including Oklahoma, Michigan, Kentucky, Kansas, Wisconsin and others, which have discussed the potential use of public/private partnerships to deal with the overcrowding conditions as well as to replace older and more costly facilities.

In the second quarter 2017 call, Dave Donahue, President-GEO Corrections & Detention for GEO Group, also echoed these thoughts, when responding to an analyst's question about where he saw growth opportunities in states.[7]

…we talked about the jurisdictions that are looking at capacity options, whether it be Kansas or Wisconsin. And again, you look at jurisdictions like Alabama who had historically had some recent debates in their general assembly. We anticipate those debates to continue in Alabama in the upcoming sessions. So as jurisdictions are evaluating their age capacity, they're also looking for more efficient physical plans to support that. And that's where we see the opportunities in the future.

GEO Group similarly explains in their 2018 Q1 investor call:[8]

Several other states continue to face capacity constraints and many of our state customers are facing challenges related to older prison facilities, which need to be replaced with new and more cost efficient facilities.

GEO Group also presented at the June 2017 National Association of REITs conference, and the company's Chief Financial Officer (CFO), Brian Evans, explained in the text of their accompanying slide show that the "foundation of our business is long-term corrections assets."[9]

The companies' REIT status is dependent on them owning real estate.

The emphasis on real estate by CoreCivic and GEO Group is in large part related to their conversions to REITs in 2013 and 2012, respectively.[10] The companies' REIT status makes it imperative to own rather than just simply manage prisons. Essentially, as REITs, the companies are able to largely avoid corporate-level taxation, as long as specified requirements are satisfied. GEO Group and CoreCivic pay a fraction of the income tax they would otherwise need to pay. In 2017, GEO Group received a $43.6 million REIT tax benefit.[11]

Because CoreCivic and GEO Group also provide services related to the operations of prisons, in addition to holding real estate, the REITs have formed taxable REIT subsidiaries (TRSs) to do the actual work of operating the facilities. The parent REIT collects contractual payments from its various governmental customers and remits payment to the TRS under an arm's length agreement.[12] To qualify as a REIT, the companies must:[13]

1. Invest at least 75 percent of its total assets in real estate assets
2. Derive no less than 95 percent of its income from dividends, interest, and real estate-related sources, and no less than 75 percent of its income from real estate-related sources
3. Have no more than 25 percent of its total assets represented by securities in one or more TRS
4. Distribute at least 90 percent of REIT income, that would otherwise be taxed, as dividends to shareholders

Although the IRS issued private letter rulings[14] to CCA (now CoreCivic) and GEO Group clearing them to convert to REITs, tax experts and scholars have questioned whether private prison companies should actually be granted this favorable tax treatment and argue that this arrangement goes beyond the congressional intent of REIT-enabling legislation. As Peter Boos, an attorney specializing in taxation issues with the firm Munger, Tolles & Olson, points out in his 2014 Tax Notes article, "Disentangling the service-related aspects of the business from the real-estate aspects is difficult," and "to suggest that this type of operation…has at its core a real estate business is, at best, a charitable description of private prisons."[15] As Boos further explains, "…the possibility of tax avoidance is an even greater concern given the potential abuse in establishing the purported arm's length terms of the deal between the parent and the TRS."[16]

Nevertheless, it is clear that the ability of CoreCivic and GEO Group to continually meet REIT requirements is directly related to their ability to own real estate and derive much of their income from rents from real estate assets. In constructing new facilities, it is more advantageous from this perspective for the companies to finance the construction and actually own the facility themselves. Additionally, it is clear that the companies are looking to increase their real estate portfolios through strategies such as scouting for opportunities to rebuild antiquated prisons or construct new facilities for governments that need additional capacity. It is therefore unsurprising that we see the companies place a greater emphasis on the real estate aspects of their businesses during a time period that coincides with their REIT conversions.

Owning facilities gives the companies more flexibility in offering contracts to meet differing political environments.

In addition to helping the companies adhere to REIT requirements, owning the facilities give the companies more flexibility in selling services to governments with differing political needs. As will be discussed in greater detail in the next section, owning the facility means that the companies can separate out the use of the facility and the actual operations of the facility. While some governments may want both the use of the facility and for the company to provide operations, other governments may only be interested in the use of the facility and want to use their own public sector staff to operate it. Companies can tailor their offerings to the individual needs and political climate or legal environment of the governmental entity, potentially allowing them to gain contracts in cities and states that haven't traditionally used private correctional facilities. For example, some states have statutory limits or bans on private prison operations, but the model of private financing and ownership of the facility combined with public operation, allows the company to gain a foothold in a jurisdiction that may have previously been considered off-limits.

CoreCivic's CEO discusses these new potential opportunities in their first quarter 2017 investor call:

> *We've been talking about for some time about how this could potentially be a great solution for states where we don't have a footprint today but we are ready to go in and develop a new project to replace an old antiquated facility.... So we think that the real estate owned solution really opens the playing field for more opportunities with other jurisdictions.*

Relatedly, this approach of offering private financing for facility construction allows the companies to take advantage of the perceived or real difficulties jurisdictions may experience in financing new construction, especially when political support for new a correctional facility may be low. For example:

- The governmental entity does not want to spend capital budget dollars on a correctional facility over other priorities.
- The governmental entity does not have the political support for passing a bond measure to build a correctional facility.

- The governmental entity faces a bonding cap and is unable to issue new bonds for correctional facility construction.

Again, as CoreCivic's CEO discussed again in first quarter 2017 investor call:

> *These kinds of transactions allow governments to, one avoid capping bonding [inaudible] capacity and spending hundreds of millions of dollars from the taxpayers to replace their prison infrastructure... Third, avoid spending any taxpayer money until the facility construction is complete and the certificate of occupancy is obtained.*

These private financing contract models essentially allow governments an off-balance sheet approach to accessing a new facility, which the companies believe will be attractive to many governments regardless of political party affiliation of its leaders. As CoreCivic's CFO explained during the 2017 National Association of REITs conference, "...so we could come in, provide the private capital to replace some of these antiquated facilities, and I think that would garner bipartisan support."[17]

Additionally, private prison companies are paying careful attention to the financial and budgetary conditions of localities, states, and the federal government. For several years, a similar phrase has been included in CoreCivic's 10-K form, which is excerpted below from the 2017 10-K.[18]

> *The demand for capacity in the short-term has been affected by the budget challenges many of our government partners currently face. At the same time, these challenges impede our customers' ability to construct new prison beds of their own or update older facilities, which we believe could result in further need for private sector capacity solutions in the long-term.*

As background for why CoreCivic and GEO Group expect increasing correctional facility construction opportunities, it's important to note that capital expenditures for new construction, renovations, and major repairs have decreased at the state level. According to a 2013 Bureau of Justice Statistics report, between 1992 and 2001, capital outlays varied between $2.7 billion and $4.0 billion, comprising between 5.0 percent and 10.3 percent of total corrections expenditures during those years. Between these same years, 32 states spent at least 20 percent of their total corrections expenditures on capital outlays. From 2002 to 2010, capital outlays made up $2.3 billion or less each year and less than 5 percent of state correctional expenditures. Between these same years, only two states spent at least 20 percent of their total corrections expenditures on capital outlays. The inability or unwillingness of governmental entities to publicly finance construction of new facilities creates a ripe environment where private prison companies can easily market their ability to build new facilities. Private ownership eliminates upfront capital costs to the governmental entity, even if higher costs are passed on over time through contractually obligated payments.

Managed-only contracts are less profitable.

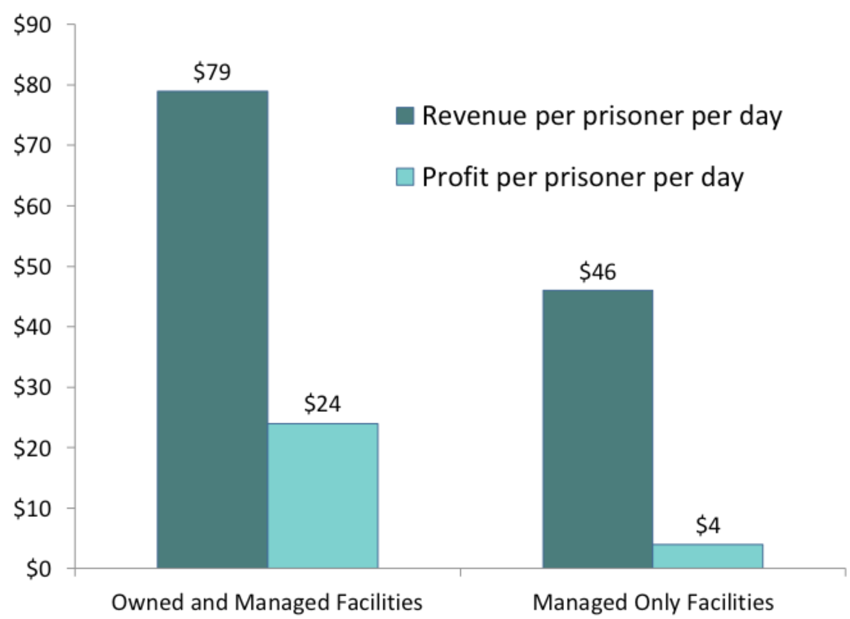
For CoreCivic and GEO Group, contracts involving facilities that the company owns are simply more profitable than contracts involving facilities that a governmental entity owns. When a government owns a correctional facility, it can only engage a private company to operate the facility. CoreCivic and GEO Group categorize these types of arrangements as managed-only contracts, since they do not have any real estate interest, but simply operate the facility. These facilities have the lowest margins for both companies and are least attractive in terms of fulfilling REIT requirements.

Facility ownership is a more profitable business strategy for private prison companies. As GEO Group's CEO George Zoley explains:[19]

> *I think our primary focus is on our lease facilities not on the managed-only. Managed only facilities have the lowest margin of financial performance available or so anybody else, so as a REIT we've grown primarily because of the ownership and leasing of facilities and that's where our primary focus remains.*

CoreCivic's financial disclosure forms show that the company receives both larger profits and profit margins by incarcerating people in facilities they own and manage compared to incarcerating people in facilities they only manage.

CoreCivic collects large profits from facilities it owns (2017)[20]



Section 2: Types of private financing arrangements for new facility construction

Past use of private financing

In the past, CoreCivic and GEO Group have used their own financing to construct new facilities. Private financing is not new. However, many of these construction decisions were speculative in nature, in that the company believed that if it built a new facility, it would attract government business. For example, in 1998, CoreCivic (then known as CCA) built a facility in California City, California, hoping that the new prison would attract new customers. As a July 1998 *Christian Science Monitor* article explained, "Although CCA does not yet have a state contract to house prisoners, the corporation is investing $100 million in the California City facility. 'If we build it, they will come,' says CCA president David Myers."[21]

This speculative prison construction boom was preceded by the company's first unsuccessful REIT conversion in 1997. CCA Prison Realty Trust was formed in July 1997 and raised more than $400 million from its initial public offering (IPO). Most of the IPO proceeds were used to purchase nine facilities from CCA. The REIT then then leased them back to CCA and continued operating them. Nine months after CCA Prison Realty Trust was established, it and CCA announced a plan under which the REIT would acquire CCA, the management company, and enjoy REIT tax benefits as the owner of CCA's prisons.[22] In order to conform to the REIT requirements at that time, the management of the new REIT's facilities and contracts were overseen by three newly formed private companies, each operating under the name Corrections Corp. of America.[23] This arrangement raised eyebrows, including those of investors. In the weeks following the announced merger, CCA's stock dropped almost 25 percent and several analysts downgraded the stock.[24]

Soon after, the company engaged in a speculative prison building effort, starting with the California City facility mentioned above. In 2000, CCA constructed the $45 million Stewart County Facility in Georgia. While the company believed that the state would need additional capacity in coming years and send prisoners to the new facility, there was never any contract in place. Upon completion of construction, Georgia declined to use the facility. Georgia's corrections commissioner explained, "This was just a speculative project; we just don't need the beds right now."[25]

CCA's REIT experiment ended with disastrous results. Their speculative construction projects prevented the company from meeting its REIT dividend obligations.[26] Additionally, the REIT defaulted on its debt and the company's stock dropped to under $1 per share. In June 2000, the company dropped its REIT status, and faced shareholder lawsuits that alleged various corporate officers and directors had concealed information and made false and misleading statements. The suits were eventually settled for approximately $104 million in stock and cash.[27]

It is important to note that the companies' most recent REIT conversions occurred after the enactment of the 2001 federal REIT Modernization Act, which states that real estate companies no longer need a completely separate company to manage their non-real estate operations and can own 100 percent of a TRS.[28] This makes it easier for the private prison companies to avoid past mistakes and conform to current REIT rules.

Private-financing today

In our examination of CoreCivic's and GEO Group's recent announcements, marketing materials, and investor-related documents, it is evident that the companies are seeking greater coordination and involvement from a governmental entity prior to constructing a new facility, hence an emphasis on public-private partnerships in the companies' materials. As discussed in this section, these arrangements rely on the company signing a contract with the governmental entity prior to construction. The company builds the facility to the government's specifications with a guarantee of prisoners once the facility is complete. As CoreCivic describes in a July 18, 2017 presentation to the state of Wyoming, payments "begin only when the government partner starts using the facility." While this sounds like a generous deal on its face, this is incredibly advantageous to the company. A contract with a governmental entity at the start of construction removes the significant risk of filling the new facilities by securing future occupancy and future revenues for the company before the company has spent any money on construction. Companies can secure funding and financing for new facilities construction through a variety of sources. As GEO Group's 2017 10-K describes, sources can include:[29]

- funds from equity offerings of company stock
- cash on hand and/or cash flows from company operations
- borrowings by the company from banks or other institutions
- funds from debt offerings of company notes
- lease arrangements with third parties

It is important to note that In the Public Interest published a 2016 report detailing CoreCivic's and GEO Group's banking relationships with Wells Fargo, Bank of America, JPMorgan Chase, BNP Paribas, SunTrust, and U.S. Bancorp. You can download the report here.

In examining CoreCivic and Geo Group's publicly available investor-related and financial documents, government bid documents related to new facility construction, media articles, state law related to new correctional facility construction, and federal level government reports on correctional facility construction, we identified several broad arrangements for privately financing correctional facility construction, discussed in detail below:

- privately financed, owned, and operated (full privatization)
- privately financed and owned, publicly operated
- privately financed and owned until transferred to public sector (lease-purchase)
- publicly owned, privately financed, constructed, and maintained, with or without private operation
- and and/or cash flows from company operations

The first three contract types are variations on a theme, with the company fully financing construction of the facility, which allows them to own the facility, at least through the contract term. Whether the company or the government operates the facility is now a choice that the companies even tout in their promotional presentations. This pulling away from facility operations, as seen in the second and third contract type described below, is likely largely driven by the companies' limits on income derived from operations as part of their REIT status requirements.

However, it is also important to note that the companies may find that their contracts that don't involve operations are less risky to the company in terms of headline and reputational risk. As discussed in greater detail in the next section, these companies have a long history of serious facility operations mismanagement, sometimes resulting in dangerous and deadly human rights abuses. Removing the operations responsibilities from the contractual arrangement removes this risk from the company, but still allows the companies to extract profits from governmental entities. CoreCivic CEO Damon Hininger expressed a similar idea about the benefits of risk transference during his presentation at the 2017 National Association of REITs conference: "So, we think [the building of facilities] could be a really meaningful catalyst for growth for the company and a great way...to diversify the company moving forward because the operational risk and the headline risk is with the government jurisdiction, we're just the owner of the real estate."[30]

Contract Model #1: Privately financed, owned, and operated (full privatization)

In this model, the private company designs, builds, finances, operates, and maintains the facility. Upon completion of construction, the company is the owner of the constructed facility. In exchange for using its own capital to build the facility per the government's specifications, the government guarantees in advance a certain level of prisoners for the facility for a specified amount of time and pays the company accordingly once the facility is operational. Unlike speculative or "spec" prisons, where the private company builds a facility in hopes of securing a future operations contract, the company and the governmental entity sign a contract laying out the arrangement before construction begins, guaranteeing the corporation a specified occupancy level for a specified time period once the facility is built. This guaranteed revenue floor makes the construction of the new facility much less risky for the company.

A recent example of this arrangement is CoreCivic's financing and construction of the Trousdale Turner Correctional Center in Hartsville, Tennessee. Hartsville, a small town with 8,000 residents, is located in rural Trousdale County, the smallest county in Tennessee and situated about an hour outside of Nashville. The state of Tennessee anticipated needing additional prison capacity to house a projected increase in felony-level prisoners.[31] Tennessee law only allows the state one privately-operated state prison.[32] The state was able to skirt this law by entering into an intergovernmental services agreement (IGSA) with Trousdale County, and Trousdale County signed an agreement with CoreCivic (CCA at the time of contract signing in 2014) to fulfill all provisions of the IGSA. Essentially, Trousdale County acted as a pass-through to allow the state to get around the law. CoreCivic agreed to finance, design, build, maintain, and operate a 2,552-bed correctional facility per the state's specifications.

CoreCivic previously owned the land, but the site did not contain a correctional facility. Documentation of correspondence between Trousdale County and Tennessee Department of Corrections shows that CoreCivic worked through Trousdale County to market their land and ability to finance and build a correctional facility on that land to the state. Trousdale County further appealed to the state arguing that CoreCivic's building of a new facility would bring "meaningful employment growth to the area and… promote further economic development in the [rural] region."[33]

CoreCivic invested approximately $144 million in constructing the Trousdale Turner Correctional Center.[34] Construction was completed in the fourth quarter of 2015 and the company began housing prisoners from the state of Tennessee in the third quarter of 2016.[35] In turn, the company stands to collect $276 million from the state over a five-year period. The contract includes a 90 percent occupancy guarantee, meaning that no matter the actual occupancy level, the company will get paid for at least 90 percent of the bed space.[36] As of December 31, 2016, CoreCivic housed approximately 2,300 prisoners at the new facility.[37]

However, in the short period that the facility has been operational, numerous problems have arisen at the facility. There have been concerns around inadequate staffing and allegations of excessive use of force and prisoners being sent to solitary confinement without explanation.[38] After only four months of operation, the state halted sending prisoners to the new facility. A March 2017 memo written by the Tennessee Department of Corrections and obtained by the Associated Press described a situation where "the guards were not in control of the housing units, were not counting inmates correctly and were putting inmates in solitary confinement for no documented reason."[39] A lawsuit filed in January 2017 alleges that understaffing at the facility has led to insufficient care for about 60 inmates who have Type 1 or Type 2 diabetes, including lack of access to basic diabetes care, such as blood sugar checks and insulin administration coordinated with regular mealtimes.[40]

Another example of this model is the Nevada Southern Detention Center. In 2010, CoreCivic (at that time known as CCA) built this facility for the use of the Office of the Federal Detention Trustee. This 1,176-bed facility is located in Pahrump, Nevada, about 65 miles outside of Las Vegas, and houses federal prisoners. The contract, signed in 2008, guarantees at least 750 prisoners. It is worth $122,250,660 for an initial five-year term and contains three additional five-year option periods, making it a potentially 20-year arrangement.[41] Like the Trousdale Turner Correctional Center, the company secured a contract with a governmental entity prior to construction of the facility. CoreCivic spent approximately $83.5 million to construct the facility.[42]

In our initial scan of potential upcoming construction of privately-financed correctional facilities, we see that more jurisdictions are considering this type of arrangement. For example, on April 13, 2017, U.S. Immigration and Customs Enforcement (ICE) awarded GEO Group a contract for the construction and operation of a new 1,000-bed detention facility in Conroe, Texas. GEO Group disclosed that it will be responsible for the design, finance, construction, and operation of the facility under a ten-year contract with ICE. The $117 million facility is scheduled for completion in the fourth quarter of 2018[43] and is expected to generate approximately $44 million in annualized revenues.[44]

Contract Model #2: Privately financed and owned, publicly operated

Another model gaining traction is an arrangement where the private company designs, builds, and finances a new facility, but unlike the model discussed above, the governmental entity operates the facility, while the private company is responsible for maintenance of the physical structure. CoreCivic calls this arrangement a “real estate-only” option because the company does not operate the prison, but constructs the physical facility using its own capital. In return, the governmental entity provides the company with lease payments for a specified contract term.

This model can be attractive for governments that may need new prison capacity to replace aging prison facilities or house increasing prison populations, but face financial or political barriers. For example, governments may face capital budget constraints or may not be able to issue new bonds to avoid hitting a municipal debt cap. Some governments may be rightfully wary of privatized prison operations, but may not see a problem with contracting with the company to privately finance the construction of additional bed space, as long as public sector staff can operate the facility.

As CoreCivic’s CEO explains in the company’s first quarter 2017 investor call, this arrangement is one that the company is currently promoting and marketing to governments:

> *We continue to see meaningful progress promoting new real estate solutions offered by Corecivic properties with more states considering a privately financed solution to address their aging prison infrastructure. In the last few months five states have publicly disclosed that they are considering their public private partnership approach to replace outdated prison capacity that would result in the long-term lease of the new real estate solutions from the private sector. Alabama, Kansas, Vermont, Wisconsin, and Wyoming have acknowledged their interest in evaluating such a solution. In these instances, CoreCivic would design, finance and construct a state of the art correctional facility to the exact specifications of the state partner to replace inefficient and outdated government owned facilities, and upon completion of construction we would commence a lease agreement with the state that would continue to provide the operations at the new facility.*
>
> *These kinds of transactions allow governments to, one avoid capping bonding [inaudible] capacity and spending hundreds of millions of dollars from the taxpayers to replace*

their prison infrastructure. Second, shift the risk of keeping a large-scale prison construction project on time and on budget which has been a consistent problem with government directed prison construction projects through a lease agreement negotiated prior to the construction of the facility. Third, avoid spending any taxpayer money until the facility construction is complete and the certificate of occupancy is obtained. Fourth, generate day-to-day operational cost savings from operating a modern efficient facility and shift the responsibility of maintaining the facility to CoreCivic allowing for a comprehensive facility maintenance program that is no longer impacted by year-to-year budget constraints which often result in significant deferred maintenance on government owned facilities. This is all the while the state maintains complete operations control of the facility.

As CoreCivic mentioned in their investor call above, a number of states are considering this type of arrangement.[45] Wisconsin, one of the states on CoreCivic's radar, is considering using this model to replace an aging prison. One proposal is to have a private company design, build, and finance the new facility. Wisconsin's law does not allow for private operation of prisons, so the state Department of Corrections staff would operate the facility, while the private company would maintain the physical structure. The contract would guarantee the private company lease payments for a specified length of time once the facility is complete. Involved lawmakers have discussed both CoreCivic and GEO Group as possible companies that could engage in this type of arrangement. This contract structure allows a company to gain a presence and secure a contract even in a place where they can't legally operate the prisons.

Interestingly, CoreCivic has also used the lease-only type strategy to fill beds in its existing facilities as well. The California City Correctional Center mentioned above, which CoreCivic (at the time known as CCA) originally built on speculation is now leased to the California Department of Corrections, with state staff operating the facility and the company maintaining the physical space.[46] The state needed additional prison capacity due to a federal court order to reduce prison overcrowding and then-CCA positioned itself as an answer to the crisis. A contract was signed in 2013 and was recently renewed in 2016. CoreCivic receives $28.5 million per year in lease payments.[47] In 2016, CoreCivic pursued a similar arrangement with the state of Oklahoma at the North Fork Correctional Facility located in Sayre, Oklahoma.[48] This arrangement provides CoreCivic a way to fill the facility, which sat empty in 2015, and collect $37.5 million per year after the first 18 months.[49] It is unsurprising that CoreCivic and GEO Group have adapted this lease model to their facility construction offerings.

This is an area where these companies see growth opportunities. During their 2017 National Association of REITs presentation, CoreCivic's CFO, David Garfinkle, explains how the company would like to expand its real estate-only contracts, where the company provides the facility, but not the operations service:[50]

Under CoreCivic Properties we actually lease three facilities to government agencies, and are looking to expand. We think that's an opportunity for meaningful growth as *there are a lot of old and antiquated facilities under operation today – up to 300,000 beds in operation over 100 years old, so I think there's a good opportunity to replace some of that antiquated facilities and just become the landlord.*

Contract Model #3: Privately financed and owned until transferred to public sector (lease-purchase)

Very similar to the privately financed, publicly operated contract model discussed above, another variation that we have recently seen proposed is the Lease-Purchase, or sometimes called, Build-Lease-Transfer. In this contracting model, the private entity designs, builds, and finances the construction of the facility to the government's specifications. Like the previous model discussed, once the facility is constructed, the public sector staff may operate the facility, while the private company is responsible for maintaining the physical structure. In reviewing proposals for this particular model, the length of the contract is much longer than the other types of public-private partnership arrangements discussed above—several decades or longer. During that time period, the company owns the facility and collects lease payments from the government. Unlike the previous models, at the end of the long-term lease period, ownership of the facility will transfer to the governmental entity. A recent presentation from CoreCivic to the state of Wyoming suggests that the governmental entity pays for eventual transfer of ownership through more expensive lease payments over the life of the contract.[51]

This model is currently being used in Kansas where a contract for the replacement of the aging prison facility in Lansing is has recently been awarded to CoreCivic. The state considered two options in building a new facility to replace the old prison:

Option #1: A private company finances, builds, and maintains the new facility, but state staff will operate it. At the end of the long-term contract, the facility transfers to state ownership. The term of the contract would be between 20 and 40 years. The length of the contract would ultimately impact the price of the lease payments the state would pay the contractor.

Option #2: The state does not involve a private prison company, but instead uses traditional bond financing to pay for the new facility. To this end, the state Legislature pre-approved up to $155 million in bond authority, which would cost the state about $12 million in annual debt service.[52]

In July 2017, the Kansas Legislative Division of Post Audit published an audit comparing the life cycle costs of the procurement options. While the Kansas Department of Corrections presented estimates in Spring 2017 before the issuance of the Request for Proposals (RFP) showing that the private-finance lease-purchase option was the least expensive option, the audit showed that the department's estimates "were missing key variables and used inconsistent assumptions that tended to favor a lease-purchase option."[53] Instead, the audit concluded that the bond financing option would be cheaper and gave three major reasons, in addition to the department's flawed analysis: 1) the state likely will have lower borrowing costs than a private contractor, 2) a private contractor will have to pay certain local, state, and federal taxes that the state would not have to pay, and 3) a private contractor would expect to earn a profit on the project, while the state would not.

Additionally, stakeholders in the state expressed concern that the Department of Corrections was prematurely favoring the private-finance lease-purchase option and the state will pay expensive lease payments for the multi-decade contract term, and then inherit a facility towards at the end of its useful lifespan.[54] Despite the findings from the audit and concerns from numerous stakeholders, the Department of Corrections continued with the procurement process. In November 2017, Kansas Department of Corrections awarded a contract to CoreCivic to design, finance, build, and maintain the new facility in Lansing. At the end of the 20-year contract term, the prison will transfer ownership to the state. The prison is expected to take two years to construct, and CoreCivic will receive a payment of $14.9 million after the first year of completion, and each annual payment thereafter will nearly 2 percent annually.[55]

In April 2018, CoreCivic secured $159.5 million in private placement bonds for financing of the construction of the Kansas facility.[56] The company hopes that this contract with Kansas will encourage other governmental entities to pursue similar types of contracts. In the company's first quarter investor call, the CEO explained, "And we know that many governments were closely watching the developments out of Kansas throughout the RFP process, the subsequent award announcement and alternate financing methods utilized. In fact, we are in active discussions with numerous states as well as local governments, who are seeking and looking at similar public-private partnership solutions for their criminal justice infrastructure needs."[57]

Contract Model #4: Publicly owned, privately financed, designed, constructed, and maintained, with or without private operation

Despite what appears to be a preference for ownership of the facility, the companies are also interested in a traditional type of public-private partnership more typically seen in large transportation infrastructure projects. In these arrangements, the private company typically designs, builds, finances, operates, and maintains the asset, but the governmental entity retains ownership. The private company can be paid back through annual milestone payments, sometimes called "availability payments," or through user fees, such as per diem rates, or a combination. Because the private company finances the construction of the asset, they are able to demand a generous return on their investment from the government. While this model does not result in a real estate acquisition for the company, these deals can be very lucrative. And due to the long-term nature of these types of contracts, the company is embedded in the government's criminal justice system for decades, allowing for a steady long-term stream of revenues.

It is worth noting that it is unclear how these types of public-private partnerships and the underlying assets are recognized by the IRS for the purposes of the companies' REIT status. While it does not appear on its face that facilities constructed using this procurement process would be considered real estate for the company since the governmental entity retains ownership of the asset, it is unclear whether a REIT can claim rent income from such an asset given its equity stake. This is an important question that deserves continued research. However, based on our initial research, it does not appear that the IRS has issued any guidance on this specific question.

The only known active construction project utilizing this structure is the Ravenhall Prison Project located outside the U.S. in the state of Victoria, Australia. GEO Group is project developer and equity investor, responsible for overseeing all aspects of the project. As the sole equity investor, the company contributed $120 million to the project. It is working with a consortium of other companies including the firm, John Holland, for engineering and construction services, and Honeywell, for facilities maintenance and security system services. GEO Group will operate the facility once it is constructed. National Australia Bank Limited, Westpac Banking Corporation, Commonwealth Bank of Australia Limited, and DZ Bank AG are the initial lenders providing the total debt financing.[58]

The contract for this 1,300-bed facility was signed in 2014 and construction is slated to be complete in late 2017. Once the prison is operational, GEO Group will run the facility for a 25-year term, until 2042. The GEO Group consortium will be paid through several mechanisms. First, it will receive regular quarterly payments based on the availability of 1,000 beds (similar to a standard availability payment in a traditional transportation-sector P3), with additional payments for extra beds on a per-diem basis. Additionally, the consortium will receive a regular payment based on meeting certain performance standards related to service provision contained in the contract. The service-related payment can be reduced if standards are not met. Interestingly, a small component of this service-related payment is connected to the company's ability to meet targets related to prisoner release, including the outcomes of pre- and post-release reintegration programs and the recidivism rate for prisoners released from the facility compared against the recidivism rate for the rest of the prison system over the same period.[59] The facility is expected to generate approximately $96 million in total first year annualized revenues for GEO Group.[60]

This type of arrangement was considered in Washington, D.C., where the city's Office of Public-Private Partnerships (OP3) began a procurement process to build a new correctional facility using this model.[61] The city was interested in having a private entity design, build, finance, and maintain the new facility. However, unlike the Ravenhall Prison, the city staff would operate the facility.[62] The city's interest in this type of public-private partnership arrangement was likely motivated by its inability to issue municipal bonds to finance a jail without exceeding its 12 percent debt cap.[63] Advocates and community groups in the city are concerned about this proposed arrangement, as the process thus far has not been transparent or open to community input, even though the proposed jail has broad sweeping implications for a city with an incarceration rate higher than any U.S. state. In

May 2017, In the Public Interest co-published an op-ed with the ACLU of the District of Columbia in *The Washington Post* that describes these issues in more detail. Plans for the new jail have presumably stalled—yet the recently passed 2019 city budget includes $150,000 for a commission to perform community engagement work around planning the construction of a new facility.

Section 3: Potential consequences of privately financed facilities

Given the increased efforts by CoreCivic and GEO Group to secure real estate-focused contractual arrangements described in the last section, it is important to understand the potential consequences of these deals. This section highlights the serious risks and consequences inherent in these different types of contracts.

Private prison construction deals embed private interests in the criminal justice system, perpetuating mass incarceration.

One of the most long-lasting consequences of these deals is the insertion of corporate private profit-seeking interests in our criminal justice system. Whether at the specific deal level, within a particular governmental entity, or within the context of the national criminal justice system, these contracts perpetuate the control and influence of these companies in permanent ways.

In reviewing potential privately financed prison construction proposals, there is evidence that some states that had not considered privatized prisons for political reasons or were wary of the companies' track record around prison operations, are now entertaining the idea of having CoreCivic or GEO Group finance and build a facility for them. They still have the ability to operate the facility with public sector staff, and as discussed in detail in this report, they don't have to pay the up-front capital costs for a new facility. In other words, it doesn't look like prison privatization in the traditional sense because the companies may not be running the facility. But, the state is still dependent on these companies for prison capacity and this can give the companies leverage in their dealings and negotiations with the state. The state has very few options if they actually need correctional space and don't own enough of their own correctional facilities.

Furthermore, in every single contractual arrangement discussed in the previous section, the incentives to fill as many beds are possible are there, regardless of whether or not the contract requires the company to operate the prison. Especially since these companies have financed the construction of these new facilities, it is even more important than a traditional management-only contract that they are able to keep the prison filled to ensure a steady and long-term stream of lease payments and other types of remuneration. The governmental entity may feel pressure to keep beds filled to justify high-cost lease payments. These contracts contain either explicit guaranteed occupancy floors, also known as "bed guarantees," or minimum monthly payments that ensure the corporation gets paid regardless of how the government uses the facility. For example, the contract for the

Trousdale Turner Facility discussed in the previous section includes an explicit 90 percent occupancy guarantee. These long-term contracts, often lasting decades, directly work against important efforts to reduce prison populations.

On a broader level, these incentives play out in lobbying and campaign contribution activity by both companies. CoreCivic and GEO Group have spent millions of public dollars in lobbying and campaign contributions. Together, they have spent more than $10 million on political candidates and have spent nearly $25 million on lobbying efforts, since 1989.[64] And what they lobby for ensures that beds are filled. There are documented instances of companies donating to politicians that support laws such as California's three-strikes rule[65] and Arizona's highly controversial anti-immigrant law, SB 1070.[66] They have also lobbied for funding for ICE, to in effect increase the number of immigrant detainees.[67]

Governmental entities that sign contracts with these companies, even if they are real-estate only contracts, should understand that these lucrative deals are what keep these companies alive and well, allowing them to further mass incarceration. The terms of these new contractual arrangements may look a little different than the traditional prison privatization contracts of the past, but many of the devastating impacts are the same.

Public-private partnerships limit the government's flexibility to respond to changing correctional needs.

Given that public-private partnerships can last for decades, it is inevitable that a government's correctional facility needs will change during the life of the contract. However, these deals severely limit what a government can do to respond to shifting correctional needs. Unlike a facility built using public financing, privately financed facilities belong to the company at least until the end of the contract term (as is the case in a lease-purchase agreement). The government cannot change how the facility and/or the land on which the facility is located are used, even if incarcerated populations significantly decline and the facility is no longer needed. When the public owns the facility and the land, it has much more flexibility, and can even dispose of the facility all together.

Public-private partnerships result in higher costs of financing for the public.

On the deal level, these contractual arrangements result in higher financing costs for the public entity, even if they are paying for them indirectly. In the proposals and discussions of these types of deals that we have examined, typically the governmental entity has two financing options with regard to building a new facility. In the first option, the government can issue tax-exempt municipal bonds. In this case, the governmental entity owns the actual physical structure. The interest rate on those bonds is dependent on the governmental entity's credit rating, but for governmental entities with an investment grade rating, rates in the past couple years have hovered between approximately 3 percent and 4 percent for a 20-year municipal bond, representing a period of historically low borrowing rates.

If a governmental entity uses bond financing, it is obligated to make regular debt service payments over the life of the bond.

With private financing, the private company finances the construction of the facility. Interest rates on this debt are usually higher than municipal bonds because the private entity may not have the same creditworthiness as the governmental entity, and their debt is not tax-exempt like the municipal bonds, resulting in a higher interest rate. While this debt often does not show up on the governmental entity's balance sheet, as municipal bonds do, these higher costs of financing are passed on to the governmental entity through their contractually obligated lease payments.

In a long-term lease scenario, the governmental entity has access to the facility for the life of the contract, but does not own the facility. The contract can be designed to allow for the governmental entity to own the facility at the end of the contract, however, there are several issues with this approach. First, the company accounts for this transfer of the asset in the contract either through even higher lease payments through the life of the contract or through the inclusion of a large final purchase payment due to the company at the end of the contract. While there are various variables to consider, typically the long-term lease option will be more expensive than the municipal bond-financing option, and the lease-to-own option will be the most expensive option. Second, these contracts can be several decades long, allowing the company to recoup their construction costs while ensuring a healthy profit margin. A governmental entity that wants to own the facility at the end of the contract term may find that the physical building is at the end of its most useful life at that point.

Public-private partnerships may decrease opportunities for public and stakeholder input.

Since these deals hand over the entire responsibility for design, construction, finance, and maintenance to one company, and bundle these project phases into one contract, opportunities for public and stakeholder input may be limited or even non-existent. When a government uses public debt and a more traditional procurement process, the project has multiple distinct phases in which the government can solicit stakeholder input, engaging in a more democratic process and increasing the likelihood that the resulting facility will reflect the needs of the community and other stakeholders, such as families of those who are incarcerated.

By handing control of the entire process to a company, there is little opportunity or incentive to solicit stakeholder input. Unlike the government, which is ultimately accountable to the public, CoreCivic and GEO Group are only beholden to their shareholders. The public and other stakeholders may not have access to important information about the construction project and resulting facility, as they would if the government was managing the process. CoreCivic and GEO Group have a history of avoiding releasing information about their facilities to the public, claiming "trade secrets" and other exemptions to open records laws, even though much of this same information would be public under a government-run facility.

The private prison corporation may not properly maintain the facility.

In all the contractual arrangements described in the previous section, the private company is responsible for maintenance of the facility. Regular and ongoing maintenance of a facility is very a crucial component in ensuring healthy and safe day-to-day conditions for both prisoners and staff. It is also of particular importance in the arrangement in which the governmental entity can take ownership of the facility after the contract term has ended (lease-purchase agreement). The level and quality of maintenance directly impacts the condition and lifespan of the facility that will become government property, especially since the facility may already be a couple decades old before ownership changes parties. Furthermore, in this particular contract model, the company has a direct incentive to defer expensive and/or long-term maintenance issues, since ownership of the facility will ultimately leave their hands.

If past experience is a guide, then there is reason to be cautious about CoreCivic and GEO Group's commitment to high-quality facility maintenance. When CCA (now CoreCivic) managed Hernando County's jail, north of Tampa, Florida, the company neglected routine building maintenance, jeopardizing safety at the facility. CCA failed to repair rusted doors, replace damaged windows, seal cracks in the walls and floors, fix damaged ceiling tiles, and patch leaks in the roof, even though maintaining the facility was a requirement in its agreement with the county.[68] When the sheriff's office assumed management of the facility in 2010, the county commissioned a report that found CCA responsible for roughly $1 million in deferred maintenance costs.[69]

"If [CCA] had performed routine maintenance as they [sic] should have and as their [sic] contract required," said Major Michael Page who led the sheriff's office takeover of the jail, "this building would look 10 times better."[70] The county withheld CCA's final payment of $1.86 million for failing to perform the maintenance that was required by the contract, and CCA sued in response.[71] The county and CCA settled the case in 2012 for $100,000, forcing the county taxpayers to cover the outstanding maintenance costs.[72]

Similarly, GEO Group's management of East Mississippi Correctional Facility raises questions about their ability to provide proper facility maintenance. In December 2011, the Occupational Safety and Health Administration (OSHA) investigated the facility and cited GEO Group for numerous workplace violations. Among the violations was GEO Group's neglect of building maintenance, which created unsafe conditions for both prisoners and correctional officers. Cell doors with broken locks could not be opened by correctional officers from outside but could be opened by prisoners from inside.[73]

In total, OSHA fined GEO Group more than $100,000 for workplace violations. OSHA concluded that the company either knew its decisions were in violation of the law or had “plain indifference to worker safety and health.” OSHA also cited GEO Group for three “serious” violations, meaning that OSHA found “substantial probability that death or serious physical harm from a hazard about which the employer knew or should have known.”[74] In 2012, GEO Group ended the contract citing financial underperformance.[75]

Private prison construction deals prop up companies with records of human rights abuses.

Regardless of whether a new facility will be operated by private or public sector staff, these deals grow and strengthen CoreCivic and GEO Group, both of which have extensive records of extensive human rights abuses. While this report focuses on the facility construction financing aspects of these contractual arrangements, it is important to note that CoreCivic and GEO Group’s track record providing facility operations has been consistently abysmal. There are numerous examples of both companies cutting corners and failing to provide humane treatment of prisoners and appropriate prison conditions, and as the Trousdale Turner Facility example in the previous section illustrates, these problems are still very much present when privatized operations is bundled with privatized facility construction. While there has been much written about the horrors of privatized operations, the following illustrative example serves as a reminder of the serious risks that governmental entities take on when the privatize jail or prison operations.

In 1997, the Idaho Department of Corrections (IDOC) opened the Idaho Correctional Center—a new 2,080-person prison south of Boise—and granted management to CCA (now CoreCivic).[76] CCA lowered its operating costs and increased its profits by cutting corners on staffing, hiring fewer correctional officers than needed for a prison of that size. Investigations in the past few years have uncovered a history of staff shortages, with important security posts left continually unfilled. In 2013, CCA admitted to falsifying records that hid 4,800 hours of uncovered shifts during a seven-month period in the previous year—equivalent to the time that would have been worked by four full-time correctional officers.[77] According to an IDOC audit, CCA understaffed the facility by as many as 26,000 hours in 2012—equivalent to the time that would have been worked by 13 full-time correctional officers.[78] A federal judge found CCA in contempt of court for hiding information on the falsified hours.[79]

A lawsuit filed in 2012 on behalf of Idaho Correctional Center’s prisoners contends that, in order to hire fewer correctional officers and reduce spending, CCA relinquished control of the facility to prison gangs, leading to violence and serious prisoner injuries.[80] Another lawsuit filed on behalf of prisoners in 2010 contends that understaffing contributed to high levels of violence, which earned the prison the nickname “gladiator school.”[81]

CCA’s understaffing decisions also put the correctional officers who were working at the facility at risk. According to Sargent Leonard King, a former CCA employee who is suing the company, one night-time guard was expected to oversee 250-300 prisoners, which jeopardized the correctional officers’ safety. King was assaulted five times before leaving the company. In addition, CCA supplied their correctional officers with empty cans of pepper spray and broken radios and told them "to just fake it" when needed.[82]

In February 2014, CCA paid $1 million in penalties for understaffing the prison.[83] Five months later, the Department of Corrections ended its contract with CCA and assumed management of the facility.[84] For more information about CoreCivic's track record, see In the Public Interest's fact sheet.

GEO Group has a similar track record. In 2012, federal District Judge Carleton Reeves wrote that the GEO Group-managed Walnut Grove Juvenile Detention Center in Mississippi was "a picture of such horror as should be unrealized anywhere in the civilized world" and "a cesspool of unconstitutional and inhuman acts."[85] A U.S. Department of Justice report found that GEO Group staff had sex with incarcerated youth and that poorly trained workers brutally beat youth while they were handcuffed and defenseless and excessively used pepper spray.[86]

These records of human rights abuses should give any governmental entity serious pause before signing any type of contract with private prison companies.

About In the Public Interest

In the Public Interest is a research and policy center committed to promoting the common good and democratic control of public goods and services. We help citizens, public officials, advocacy groups, and researchers better understand the impacts that government contracts and public-private agreements have on service quality, democratic decision-making, and public budgets. For more information, please visit inthepublicinterest.org.

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