

A BRIDGE TO SOMEWHERE


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PUBLIC-PRIVATE PARTNERSHIPS & AMERICA'S INFRASTRUCTURE DILEMMA

AN UNDENIABLE NEED FOR INFRASTRUCTURE EXISTS
IN THIS COUNTRY WITH A SEEMINGLY INSURMOUNTABLE
SHORTFALL IN AVAILABLE PUBLIC FINANCING.



THE AMERICAN
SOCIETY OF CIVIL
ENGINEERS (ASCE)
2013 REPORT CARD
FOR AMERICA'S
INFRASTRUCTURE GAVE
INFRASTRUCTURE A
"D+" – ONLY A SLIGHT
IMPROVEMENT OVER
2009'S "D" GRADE,
WITH NEAR FAILING GRADES
IN MANY INFRASTRUCTURE
SECTORS INCLUDING DAMS,
LEVEES, DRINKING WATER,
WASTEWATER, INLAND WATERWAYS,
ROADS, TRANSIT, AVIATION, AND
SCHOOL FACILITIES.¹ THE ASCE
ESTIMATES THAT \$3.6 TRILLION IS
REQUIRED BY 2020 TO REPAIR THE
COUNTRY'S INFRASTRUCTURE.

Deferring infrastructure investment is not a viable option. Studies show that deferring timely maintenance, repair, and replacement can greatly increase the total cost of infrastructure repairs by a ratio of 15:1 to more than 40:1.² This does not take into account the multiplier effects that a bottlenecked or overburdened infrastructure system would also have on the cost of goods and quality of life for most Americans.

Public-Private Partnerships (P3s) have been touted as a solution to these shortfalls. In fact, Moody's recently predicted that the U.S. is primed to become the world's largest market for P3s, citing the country's increased infrastructure needs and public financing difficulties, as well as the recent number of stateside P3 deals and increased adoption of P3-enabling legislation at the state level.³

According to the National Council for Public-Private Partnerships (NCP3P), a P3 is defined as "A contractual agreement between a public agency (federal, state, or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility."

Broadly speaking, P3s couple private financing with repayment from revenues generated by the public project, which means that the public entity is relieved of allocating financing for that project. Ultimately, projects are paid for by user-generated fees (e.g., road or bridge tolls, rents, or other user fees).

Many proponents assert that P3s will not only provide much-needed financing, but will also be less susceptible to delays and cost overruns that commonly afflict traditionally financed public projects.⁴ Although U.S. public entities were initially reluctant to use P3s, there are now many creative and high-profile P3s underway, and governments are more frequently considering P3s as solutions to problems in funding infrastructure projects.⁵

State and local governments face their own budgetary and political constraints while the political and fiscal challenges in modern-day Washington D.C. would likely stymie any federal attempt at tackling the issue. For example, the Army Corps of Engineers estimates its work backlog at \$60 billion but only receives roughly \$2 billion in annual federal funding. The Corps' commanding general

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recently expressed interest in P3s to address this shortfall as the Corps' projects currently in progress alone will require \$23 billion to complete;⁶ however, such projects may be difficult to monetize. For instance, collecting fees from shipping companies for use of waterways and ports provides a natural revenue stream, but generating revenue from a levee project can be more problematic.

The President has touted P3s as a funding solution for all forms of public services, stating in April 2013:

It's a partnership with the private sector that creates jobs upgrading what our businesses need most – modern ports to move our goods; modern pipelines to withstand a storm; modern schools worthy of our children...we're going to fund more projects, at less cost, by establishing a new infrastructure initiative... [i]t's going to give mayors and governors more flexibility and power to attract private investment for public projects.⁷



Photo: Holiday Inn Express, Fort Rucker
Credit: Lend Lease



Photo: Holiday Inn Express, Fort Hamilton
Credit: Lend Lease

P3s As a New Form of Procurement

Historically, public projects have been financed through a combination of federal or state grants and municipal or general obligation bonds. Bonds provide a reliable source of funds at a low borrowing cost. Investors receive security in the form of a pledge that public resources (e.g., property taxes) will be used to repay the bonds. In many cases, tax advantages to the bond investors translate into lower interest rates for the public.

Traditional public procurement typically involves a phased approach for planning and design of a public project, followed by the issuance of public debt. Then, the bidding and award of the public works contract to the lowest-price qualified bidder follows. The advantages with this approach include clear criteria, transparency, and the participants' familiarity with the process.

However, the process can be rigid and slow moving. The local authority is responsible for any cost increases, design changes, or changes in conditions along the way, and the lowest-price bid does not always result in the best product. In traditional public procurement, the local authority is also responsible for the operation and maintenance (O&M) of the completed project.

P3s typically combine the bidding of all of these procurement phases, including the O&M, into a single process. Typically, proposals to finance, construct, and/or operate the completed project, as well as to then recoup investment with project-generated revenues upon project completion and opening are submitted all at once. However, because P3-enabling statutes typically give the governing authority wide latitude in awarding a contract to the successful bidder (price is one of many factors that the awarding authority can consider), the P3 process injects a new inherent risk: Competing bids cannot always be compared apples-to-apples, since design specifications may not always be uniform across all bids. The last page compares the benefits of P3s with risks that must be addressed.

P3s can take many forms, ranging from design-build to design-build-finance-operate-maintain projects to long-term lease concessions,⁸ and they differ according to the types of project risks (such as construction, O&M, financing, or demand risks) transferred to the private entity (commonly called a "concessionaire") as well as the financial arrangement (e.g.,



tolls, rents, availability payments, and shadow tolls) by which the concessionaire may provide financing.⁹ Recent trends indicate that models where the risks of revenue shortfalls are transferred to the concessionaire are gaining popularity in the U.S.¹⁰ There is no “one-size-fits-all” P3 formula, but common characteristics include:

- 1) A contract between a public agency and a concessionaire for a time that outlasts the construction phase;
- 2) The concessionaire, in exchange for a revenue stream or other long-term stream of payments as compensation, delivers physical infrastructure and/or infrastructure-related services;
- 3) The public agency retains ownership of this public good or asset; and,
- 4) The public agency transfers project-related risks to the concessionaire.¹¹

How Are P3 Contracts Awarded Differently?

It is becoming increasingly common for commentators and public officials to use the “P3” label in describing traditionally financed projects that are built alongside private developments (e.g., the infrastructure that supports a new stadium or a new town center that includes both government buildings

financed using traditional government procurement processes for the public “piece” of the overall development, with general obligation bonds to finance and traditional bidding to award the public works contracts.

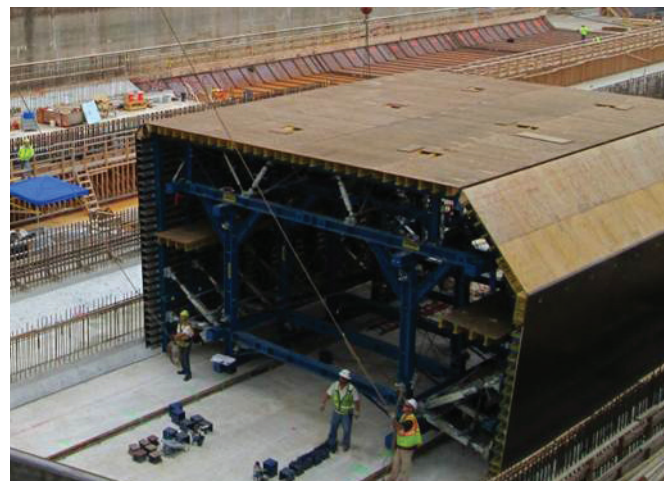
New P3 legislation authorizes a new process of procurement, with a different bidding process and allowance for more flexibility in selection criteria. One source has stated that “P3s represent not a new model, so much as a place on the continuum between wholly owner-driven projects and purely collaborative, shared-risk models of project execution.”¹² But P3s depart from traditional procurement in that private parties are commonly permitted to make unsolicited proposals to governments based on a “public need,” and a project can be awarded based on criteria that are less clearly defined and rigid than traditional procurement (e.g., see Florida Statute §334.30 and §339.2825).

While early P3 legislation focused on “horizontal” transportation projects, states have recently enacted or introduced laws covering schools, governmental offices, and other “vertical” projects. In addition to enabling public entities to enter into P3 contracts, this legislation seeks to ensure transparency and equity in this more subjective procurement process while defining the maximum term for the repayment of debt and surety/performance bond requirements.¹³

High-Profile P3s

A survey of high-visibility P3s demonstrates the flexibility and attractiveness of P3s as an alternative procurement method, but also demonstrates where precautions should be taken.

Photos: Elizabeth River Tunnels
Credit: Skanska USA Inc.



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DOWNTOWN SAN ANTONIO DEVELOPMENT

In Texas, the City of San Antonio recently announced its consideration of an unsolicited proposal for a P3 that would involve the exchange of downtown properties, including a bank building and parking garage, conveying ownership to the city government and private developers receiving five city-owned properties.¹⁴

The proposal contemplates cancelling \$3.4 million in city office lease obligations and moving city operations to the old bank building, while the bank would occupy a new skyscraper to be built on the previously city-owned land and redevelop other public buildings into residential units. Under this proposal, the city and the bank would enter into a short-term lease of the existing bank property where the bank and existing office tenants would maintain uninterrupted operations until the opening of the new bank tower.¹⁵

This is the first unsolicited proposal submitted under San Antonio's new "P3 Guidelines" ordinance. A broad enabling statute in Texas provides for the submission of proposals to compete with an unsolicited proposal, as well as a public comment period.¹⁶

This project is a clear example of how an apples-to-apples proposal can be impossible in certain circumstances, but also how P3s allow for sensible and creative solutions that may not be available under traditional public procurement.

THE 595 EXPRESS IN FLORIDA

This project involves the widening of an approximately 10-mile stretch of I-595 in the metro Fort Lauderdale area between the I-95 and I-75 interchanges to install three reversible, at-grade express lanes, along with associated road improvements. The 595 Express is slated for a 35-year term, where the concessionaire will construct the toll lanes for five years and then maintain the roadways for 30 years thereafter.

Before construction commenced in 2009, the concessionaire obtained a 35-year *Transportation Infrastructure Finance and Innovation Act* (TIFIA) loan of approximately \$655-680 million, and multiple 10-year private loans totaling \$780 million, in addition to pledging \$210 million of its own equity to finance the project. Upon completion, the Florida Department of Transportation (FDOT) will pay approximately \$65.9 million to the concessionaire annually over the last 30 years of the contract.

Since FDOT did not begin disbursement of the availability payments to the concessionaire until the 595 Express lanes became fully operational, the concessionaire took on considerable delay and cost overrun risks. (The project is now complete with all lanes open.¹⁷)

At the time of the 2007 request for proposals, it was estimated that FDOT had a \$700 million budgetary shortfall for these improvements and that the construction phase under a traditional procurement would take 20 years, a considerable delay given the population growth trends in this area of Florida. The project was delivered in five years and overall savings (for O&M and other expenditures) over the 30-year payback period is estimated at \$2.4 billion. In addition, the concessionaire could earn a 12% return on its investment over the 35-year life of this P3 project.¹⁸

U.S. HIGHWAY 460 IN VIRGINIA

This project demonstrates a number of the P3 risks identified on the last page. This project was to be a \$1.4 billion, 55-mile limited access toll-expressway between Suffolk and Petersburg,¹⁹ under which the private developer consortium would be compensated according to a schedule of monthly payouts funded through a mix of toll revenue bonds and public financing over the 40-year term of the P3. The developers have yet to break any ground on the project, but have already received \$250 million in payments from the state.

Virginia's governor shut down the project in March 2014, citing failure to obtain environmental permits from the Army Corps of Engineers before commencing construction. The state secretary of transportation estimates that the project could cost Virginia \$500 million, even if the highway is never built.

In June 2014, the Virginia Inspector General and the Virginia Department of Transportation (VDOT) issued a report finding that the prior governor's administration had been "very aggressive or extremely aggressive" in pursuing the procurement of the project,²⁰ perhaps aided by the fact that a single person was given authority over the project development process; such authority for traditionally procured design-build projects is shared by various divisions within VDOT.

The VDOT report found that the process was not transparent regarding project risks and stated that "little risk was transferred from VDOT to the [private financier] and no risk [other than construction risk] was transferred to the design-build vendor." The VDOT report also found that "this project



was substantially the same as a VDOT design-build project,” except for the \$250 million in bond funding from the public [funding] corporation.

Interestingly, the report finds that investigators “do not believe that key stakeholders, including the public, were aware of the nature and extent of the risks associated with the [U.S.] 460 project” and makes numerous recommendations to modify the P3 procurement process.

The U.S. 460 project controversy shows many potential pitfalls for P3s and the VDOT report seems to indicate that many of the benefits that P3s are intended to offer were not included in the awarded contract.

BIOPHYSICS CANCER RESEARCH

A P3 among the National Science Foundation (NSF), National Cancer Institute (NCI), Stand Up To Cancer (SU2C), and The V Foundation for Cancer Research was recently announced and will provide \$11.5 million toward research in the field of transformational, theoretical biophysics that may create new leads on cancer research and treatment.²¹

Though not directly related to the construction industry, it is interesting to note that P3 concepts are being applied across multiple sectors. This announcement follows others regarding similar research P3s, such as the Oncology Innovation Alliance (OIA), a P3 of universities and a pharmaceutical company focusing on the discovery and development of novel therapies for certain types of hematologic cancers and solid tumors.

Financial details of these P3s are difficult to obtain, but the driving concept behind them is to access more financing for strategic areas of research that have high payoff potential, while the risks of investment can still be shared across multiple organizations.

Conclusion

While no one can predict exactly how much public spending will shift from traditionally financed projects to P3s, it is clear that P3s are gaining ground and will be considered for a wide range of projects and public services in the future.

With the need for bidders to bring their own financing to the table and the opportunity to provide unsolicited bids to

public agencies, it is also clear that contractors will need to rethink their strategies for becoming involved in these types of public works projects. ■

Endnotes

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DON'T MISS
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& Risks**
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P3 BENEFITS & RISKS

Often-cited advantages of P3s include the participation of private sector financing and the greater incentive on the concessionaire's part to deliver the project on time and on budget (its stream of long-term payments is put at more risk by cost increases and project delays than a contractor completing a traditional procurement job with a one-time payout at completion).

The following chart compares the benefits of P3 with new hurdles that must be considered.

PERCEIVED P3 BENEFIT	NEW RISK(S) TO CONSIDER	MITIGATING THE RISK(S)
<p>1 Shorter procurement cycle and accelerated project delivery because funding, design, construction, and O&M are combined into one contract bidding and award cycle.</p>	<p>Lack of understanding of long-term costs could lead to buyer's remorse.</p> <p>Fewer bidders will be able to participate due to requirement that bidders bring financing to the table, potentially having a negative effect on the market benefits of competition.</p>	<p>Detailed and specific analyses of the public's needs, what value a proposed project would provide, and consideration of alternative solutions should still be performed.</p> <p>Evaluation process should include well-informed bid evaluators, as well as a rigorous, documented, and defensible selection process.</p>
<p>2 Private funding increases access to capital, often with fewer political hurdles to obtain approval.</p>	<p>Private funding is often more expensive than public funding.</p>	<p>Incorporation of life cycle considerations (cost of construction, financing costs, and O&M costs) in the initial proposal can help determine whether P3 or traditional financing will provide better value.*</p>
<p>3 Selection criteria allows for alternative proposals that are not limited to owner-issued design documents.</p>	<p>Apples-to-oranges comparisons make the selection process more subjective and less transparent.</p>	<p>P3 selection process is more subjective. A clear and transparent conflict of interest policy by the public entity and political accountability (such as open comment periods under P3 enabling statutes**) are important to ensure fairness in the award process.</p>
<p>4 Common infrastructure project risks (e.g., construction delays, design changes, land acquisition problems, politics) are either mitigated or transferred to the concessionaire.</p>	<p>Political delays to a project can be as expensive, if not more expensive, under a P3 structure.***</p> <p>Risks are built into the revenue stream (i.e., the price) charged by the successful bidder.</p> <p>Insolvency of private partner could be more disruptive and difficult to resolve in P3 context than if successful bidder's role is limited to construction work.</p>	<p>Selection criteria should include financial wherewithal of bidder(s) and reliability of project financing.</p>
<p>5 The risk that a project will generate less revenue than anticipated is transferred from the owner to the concessionaire (depending on the type of project).</p>	<p>P3 proposal may be structured to have public entity fund any shortfalls.</p> <p>Concessionaire may reap windfalls if revenues exceed expectations.</p>	<p>Independent, detailed financial analyses**** of a project and a robust bidding process with multiple bidders will mitigate risk that public receives anticipated public works and services at a fair price.</p> <p>P3 contract can include revenue-sharing provision(s) above certain agreed levels to prevent concessionaire from obtaining excessive windfalls.</p>
<p>6 O&M risks are shifted to the concessionaire, encouraging the use of higher quality construction techniques and materials (rather than the cheapest), as well as cost and energy savings than theoretically would be reflected in a traditionally-procured lowest qualified bid procurement.</p>	<p>O&M becomes a matter of contract, not a matter of political accountability.</p> <p>Any post-contract changes would likely come at a cost to the public.</p>	<p>This underscores the need for a sophisticated and carefully thought-through, defensible, and documented bid selection process and contract negotiation.*****</p>

*enr.construction.com/business_management/finance/2014/0901-las-vegas-nixes-p3-for-project-neon.asp. (Subscription required.)

**For example, Florida's "horizontal" P3 statute requires the Florida Department of Transportation to publish all unsolicited proposals and also accept competing proposals to the unsolicited project for 120 days after initial publication. See Sections 334.30 and 339.2825, Fla. Stat.

***For a time, Georgia's West-by-Northwest P3 project, a plan to add managed toll lanes to Interstates 75 and 575 in Cherokee County fell victim to changing political priorities in the state government, likely costing interested firms significant sums for pursuing the project before cancellation. See Dave Williams, "After Nine Years, State May Leave 'P3' On Side Of Road," *Atlanta Business Chronicle*, January 20, 2012. However, the project resumed in late 2013 as the Northwest Corridor Project and completion is scheduled for spring 2018. See www.fhwa.dot.gov/ipd/project_profiles/ga_northwest_corridor_project.aspx.

**** Value for Money analysis, or other valuation method, should be employed and all life cycle costs should be accounted for before the P3 contract is executed. onlinepubs.trb.org/onlinepubs/nchrp/nchrp_syn_391.pdf.

***** For more information, see transportation.house.gov/news/documentsingle.aspx?DocumentID=393762.