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Public and private marriage

For P3s to be successful, governments must educate themselves, dispel common misconceptions and carefully tailor their projects' approaches

Sep 26, 2017 **Jason Axelrod** | ***American City and County***

What is in this article?:

In February 2013, Long Beach, Calif. officials began preparing an RFQ for a private partner to help the city design, build, finance, operate and maintain a new city hall and library to replace existing, seismically vulnerable facilities. Given their need for a cost-efficient, timely and efficient process, officials decided to procure the project through a public-private partnership (P3).

Fast-forward to the present. Long Beach will debut its new civic center — which consolidates a revitalized park, city hall, library and parking facilities — by June 2019. Individual city departments occupying the buildings will help fund the project through annual payments to Plenary-Edgemoor Civic Partners (PECP), which is designing, building, operating and maintaining the center for 40 years. After the period ends, PECP must return the building to the city in a defined condition, upon which ownership will revert to the city.

"It really is a partnership," says Long Beach Director of Public Works Craig Beck. "You're not just setting them off to go do something on their own. The city has been very involved with the design and the layout and the functional uses of this new building."

P3s like Long Beach's are not a new concept, but they're increasingly being used as a means of procuring and delivering local and state government projects. P3s offer several advantages, but they also come with several common misconceptions on the public side. And while P3s can be as diverse as the governments that use them, experts agree that the most successful P3-utilizing projects ideally share several traits.

A matrimonial metaphor

The National Council on Public-Private Partnerships (NCPPP) defines a P3 as "a contractual arrangement 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 a P3, resources, risks and rewards are shared as well.

Multiple P3 experts compare a P3 to tying the knot. "[A P3] is a long-term contract, it's like a marriage," says NCPPP Executive Director Todd Herberghs. "You're in this together. There's shared risk, there's shared reward. The private sector is a true partner, versus a vendor that can be fired at any time."

Contrast this with traditional contracting for a given asset. Multiple contracts can be issued, they can be short-term and sometimes ended at will. Jill Jamieson, group managing director of public institutions at Jones Lang LaSalle (JLL), likens such contracting to bachelorhood, in that a government will contract with many companies while assuming all the risk.

"[The public sector is] dating around with a lot of different contractors," says Jamieson, whose company has served as a P3 advisor to governments as well as a private sector partner in P3s. "We're playing the field, we have a lot of contractors each doing small pieces of something. The public sector, we are assuming all of the risk. So if there are cost overruns… scheduled delays, generally the taxpayer pays."

A P3 however, is what District of Columbia Office of P3s Director Seth Miller Gabriel calls an all-inclusive, long-term contract on one asset between a government and "a consortium of private sector firms" that can accomplish diverse asset tasks like designing, building, operating, maintaining and setting up the legal and financial frameworks for a P3 project. But like any marriage, there can be downsides.

“Getting out of [a P3] agreement is very difficult,” he says. “These relationships are like a marriage — it’s very long term and getting divorced can be very expensive. So [governments] have to be careful who they have as their partner in this long-term relationship.”

Such a contract often entails that the private sector entity design, build, maintain, operate and/or finance certain aspects of a project. The accountability that comes with those responsibilities and its ensuing risk allocation is a major differentiator between P3s and traditional contracting. “If the part of the team on the private side that’s supposed to be doing the maintenance is not doing it, there’s penalties that occur,” Miller Gabriel says.

While Jamieson points out that a P3 will never put all risk on the private partner, the risk allocation that comes with a P3 is one of several advantages of the model.

The power of private partners

The collaboration that takes place in a P3 draws on the strengths of both the public and the private partners, explains John Parkinson, executive director of the Association for the Improvement of American Infrastructure (AIAI). “It’s simply a matter of optimizing the advantages or the skills or strengths or experiences that each has, so as to deliver the maximum value for the taxpayers.”

However, the private sector brings several aptitudes that public entities might not possess. Just as P3s often cover the lifecycle of an asset, so too are the benefits of working with the private sector felt throughout each stage.

The benefits can be felt as early as the design phase itself. Partnering with the private sector can yield more creative designs, which often keep the life of an asset in mind while optimizing risk allocation, Parkinson says.

Part of this comes with the knowledge and experience that private companies have in building more projects than public agencies would, especially as contractors for public entities, says Jim Ziglar, specialist leader of infrastructure, advisory and procurement at Deloitte, which consults with governments on P3s. “They can bring a lot more innovative, new latest thinking that people in the government don’t necessarily know because they just don’t do as many projects.”

With that experience also comes a lack of political pressures on the private sector that public entities may feel, Ziglar says.

The aforementioned risk transfers between a government and a private partner holds several advantages for governments. It relieves some of the financial risk involved in constructing a project, Miller Gabriel notes. The risk transfer also comes from the private sector's assumption of tasks like operations, management and maintenance over an asset's lifecycle. That assumption can ensure maintenance throughout the contract and relieves the need for governments to defer maintenance on an asset, which can often come from underestimating asset-related expenses from the beginning. Regardless, planning a P3 contract requires governments to conduct a lifecycle analysis of a project.

"I think it's the nature of government just to look at the capital expense and then not worry about the maintenance costs," Miller Gabriel says. "If those maintenance costs really are much higher, then unfortunately those are the budgets that get cut, and that's why the state of infrastructure is not really what it should be right now in the United States."

Dispelling delusions

With that assumption of operations and maintenance can come the erroneous belief that P3s entail the selling of an asset or that the private sector can have too much control of an asset. Multiple experts note that relating P3s to this kind of privatization is one of the most widespread misconceptions about the model. The reality is quite the opposite, according to Parkinson.

"This is not about selling an asset and getting rid of it," he says. "Throughout the lifecycle of the asset that we're talking about — the design phase, the construction, the financing, the operations and the maintenance, where all of those efficiencies are to be gained… [they] all take into consideration the bigger picture and the asset still being owned by the government entity."

"It's the taxpayers who are paying for it, so it's the taxpayers… the users of that facility [who] are ultimately the ones who are going to be the beneficiaries of it, and therefore they're the ones who should still own it," he continues.

This addresses another common misperception of P3s — that they yield "free money." A P3 functions as a procurement, project delivery and financing mechanism, but not a funding one, Jamieson notes. That procurement and delivery mechanism generally delivers a project "better, faster, cheaper" and more efficiently over a project's lifecycle, according to Ziglar. So while the private sector will certainly assume some financial risk, the government will still have monetary skin in the game.

A government can finance a P3-generated asset in multiple ways. If an asset generates revenue — Herberghs cites toll roads, stormwater infrastructure and housing as examples — then a portion of those revenues can be used as concession payments for the private partner. For projects that don't generate revenue, a government will often pay its private partner through availability payments, or defined budget appropriations.

Given each project's individualistic nature, such funding methods could vary considerably across P3s. But "in general, if you've got a project that you don't know how you're going to pay for it over its life, a P3 can't solve that problem," Ziglar says.

This in turn, highlights another major public sector misconception of P3s, which is that they are a cure-all for any kind of public project. P3s are not a one-size -fits- all model; they won't work for every project. Parkinson calls P3s simply "another tool in the toolbox."

While P3s can work well for some projects, experts agree that most successful P3 project share certain characteristics, and that the private sector looks for such characteristics in consideration of becoming a private sector partner for a P3.

Priming for P3 perfection

The first thing local governments should know when exploring a P3 is that it entails a different way of doing things, Herberghs says. "Initially, it could be a little jarring."

A major characteristic of a successful P3 project is that it addresses a "specific and critical need," as Parkinson explains. "These are not wish list projects," he says. "If there's a criticality to the project, to the need — that's the first check in the box."

While traditional contracts can be procured with a specific design in mind, a P3 is best procured with a less prescriptive design, says Jennifer Hara, manager of P3s for the Institute for Public-Private Partnerships, a P3 advisor for both sectors.

"You know what it is that you want to be delivered, in terms of the service and perhaps by when," she says. "But you leave that flexibility in the procurement process for the private sector to be innovative and to come up with a better way to build that project and then deliver that service."

However, certain aspects of the project should be clearly defined, like clearly allocated risks, Jamieson notes. The idea must be clearly defined (i.e. building a road) versus voicing general concepts like “recreation.” An identified and dedicated revenue stream should be present as well, whether from concession payments or availability payments. Measurable outputs like achievements should also be defined.

Geoff Stricker, managing director of frequent private partner Edgemoor Infrastructure & Real Estate, recommends that governments issue an RFQ before an RFP to properly review a potential private partner’s qualifications and experience before more complications get introduced in proposals. Doing so, he says, often yields a better project than a one-stage RFP would.

“We’ve seen examples of projects where perhaps unqualified firms have made a shortlist in one and run into problems,” Stricker says.

Experts agree that the best P3s come from public entities that are prepared for such projects. Just as P3 projects must be procured a certain way, so too must the public sector team behind it be organized and properly versed in P3s.

The first step for a local government interested in a P3 is ensuring that the government’s state allows P3s for the type of project in question and what restraints (if any) exist, Herberghs explains. A government should then find any state-level guidance on P3s. “Very few states have that, so sometimes it can be daunting for a local government professional.”

As such, getting educated on P3s becomes paramount. Parkinson recommends contacting public officials who have handled P3s before, contacting P3 associations and attending industry conferences.

A key corollary to education and an important step is involving experienced third-party advisors and consultants throughout the planning and ultimate execution of a P3. The reason is two-fold: it helps a government feel empowered and avoid pitfalls. But having advisors on hand is also more attractive to the private sector.

“Especially if you haven’t done P3s before, people are going to look around and they’re going to say, ‘who’s advising this organization?’ And if it’s a group of advisors who have never done a P3, they’re going to be a little more reluctant to get heavily engaged than if it’s a group of advisors who have,” Ziglar explains. “It’s the lawyers, it’s the financial advisors, it’s the technical advisors, all three of them.”

Having those advisers work with an interdisciplinary internal team that handles the P3 is also critical, Hara and Ziglar note. Because P3s simultaneously involve so many work strengths like engineering, law, procurement and finance, having all of those officials work in unison makes the process much more efficient and easier to navigate.

Most experts agree that a key part of each P3 project is a “political champion” — someone with significant government power (like a mayor, city manager, county chair, etc.) who is willing to do what it takes to see a P3 project through. Sometimes, that may entail a change in legislation or regulations, but “if you don’t have political support for a project, then there’s really no point in doing it,” Miller Gabriel notes.

“I’ve been doing this for 30-something years and every project that has been successful had the right political champion behind it, who was not only the champion but was empowered to go forward,” Jamieson says.

For Long Beach and its new civic center, those champions were the city manager and the mayors in office throughout the project. Because of the champions’ combined efforts with other city officials and outside advisors, Public Works Director Beck knows his city will be getting a great civic center in two years, as well as in about 40 years, once ownership reverts to the city.

“I now have a 40-year partner,” he says. “It’s not just design it, build it and walk away. They are coming up with a design and they are constructing a building that they need to make sure is efficient and, I’ll say profitable for them, but that operates in a profitable environment for 40 years.”

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