BY LEE A. WEINTRAUB

PUBLIC-PRIVATE PARTNERSHIPS: *Is Your Company Ready?*

Public facilities and infrastructure are becoming dated and new ones are required, but public universities and colleges, counties, municipalities, school boards, and other public agencies no longer have sufficient funds to meet these needs. What is there to do?

Enter Public-Private Partnerships (P3s).

The form and structure of P3s are varied and few P3 projects are alike in that regard. In its purest form, a P3 is a partnership between a public agency and private entities to deliver projects for a public purpose.

Under a traditional P3, a private entity will design, build, finance, operate, and maintain facilities for public use over a designated time period (typically decades). The funding is initially provided by the private entity with the aim of repayment and a return on investment (ROI) earned from a combination of project-driven operational revenue, available public funding, and other income sources creatively identified by the parties.

P3s are complex and risky, but if done correctly, they can be very lucrative to the private entity and beneficial to the public. This article will address the benefits and pitfalls of P3s with information on how your company should prepare to participate.

P3 Benefits for Public Agencies

The availability of private funds to pay for the initial design, construction, and operation of public facilities in exchange for an ROI during the operation phase helps public agencies satisfy unfunded public needs.

External Funding Sources

Not only may the public agency pay for the development over a long period of time, but also the payments need not be solely from the public agency's coffers. Rather, they are usually augmented by various external funding sources – including revenue generated from the operation of the facility itself. In that manner, a P3 acts almost like a loan to the public agency without significantly impacting the agency's debt burden.

Speed & Quality

P3s can also deliver projects quicker than traditional procurement methods because financing is available as soon as the contracts are signed. Furthermore, the private entity is eager to complete construction and start operations to begin generating revenue for its repayment. Quality will not necessarily be compromised by speed of construction because the private entity must absorb the costs of maintaining the facility during the typical decades-long operation period.

Long-Term Costs & Efficiency

Long-term costs to the public agency are often reduced because the private entity will bring its expertise in designing and constructing the facility to reduce operational costs and increase efficiency. The private entity's incentive to increase profits inures to the benefit of the public owner as well.

Risk Transfer

Further, some or all of the adverse facility performance risks, such as low tenant occupancy for a mixed-use facility or poor attendance for a stadium, is transferred from the public owner to the private entity. The extent of this risk transfer varies by project and is the result of contract negotiations, but almost invariably makes the project more financially feasible for the public owner.

Operation & Maintenance Costs

The public owner also benefits from how P3s reduce the appropriation risk for future costs of operating and maintaining the project. Public entities often pay for the operation and maintenance costs from funds annually appropriated by the state legislature, which may change from year to year. When the amount appropriated to the agency declines, the agency's ability to operate and maintain the facility is compromised.

In a P3 project, the private entity pays to operate and maintain the facility regardless of whether the legislature cuts allocated appropriation payments. Therefore, the public owner is ensured a consistent level of operation standards regardless of the amount annually allocated to the public agency's operational budget.

Ownership

Finally, at the end of the predetermined operations period, ownership and operation of the facility are turned over to the public owner. Since P3 project agreements usually require high maintenance standards, the facility will be nearly as good as new when the public owner begins operating it.

For all of these reasons, P3s permit public agencies to build facilities and infrastructure in whole or part with private funding in exchange for repayment to the private entity once the project begins operations. When lower costs and risks combine with quicker facility development, public entities can provide improvements that fulfill a public purpose in an uncertain economy. Without P3s, public agencies might not be able to meet these obligations.

P3 Benefits for Private Entities

While the benefits just mentioned inure to public agencies, the benefits for private entities are just as significant.

Since P3s are best suited for large complex jobs with some level of risk, the ROI to a private entity is usually significant enough to attract investment. The profitability of any P3 varies by project and depends upon the costs of design, construction, and operation as well as the amount and stability of revenue from which the private enterprise will be repaid.

If a project generates revenue by its very nature (e.g., a toll road, convention center hotel, or stadium), then a portion of the revenues will be paid to the private entity during the period that it operates and maintains the project. The private entity's share of operational revenue may be supplemented by such other revenue sources as allocation of tax revenue, issuance of public debt, annual appropriations from the legislature, and a portion of savings to the public entity from not having to operate or maintain the facility. Creative solutions, such as new market tax credits, could also augment the revenues.

Many P3 projects incorporate mixed-use facilities as part of the public facility development to generate additional revenue to repay the private entity. For instance, public parking garages are increasingly combined with retail, residential, or office spaces as part of the structure, with the rental income allocated in whole or part to the private entity as part of its repayment.

When properly conceived and forecasted, P3s can be very lucrative to private entities. The amount a private entity can earn on 40 years of operating a revenue-generating facility

should far outweigh the costs of designing, constructing, operating, and maintaining it.

The proliferation of P3 projects throughout the U.S. is testimony to the profits available to private entities when properly forecasted, as well as the benefits to the public agencies with which they partner. Those in the public sector who use the facilities are the true beneficiaries, as public improvements are provided at a lower cost and in less time than traditional public procurement methods.

Address Risks & Pitfalls

Unfortunately, P3s are not for every contractor or every job. There are a number of pitfalls that should be addressed and reconciled during project negotiations to ensure the project's success.

Public Support

There is a popular misconception that with P3s, public agencies shed their obligations to provide public services. If the public does not support the need for the facility or the idea of constructing it with private participation, then political pressure can impede or kill the project. So, it is critical that someone on the public side assumes the role of "project champion." The project champion leads the project delivery team through the channels of public opinion and bureaucracy without getting derailed by red tape or political outcry.

Jane Garvey, North America Chair of Meridiam Infrastructure (a P3 investment firm), states, "We need to educate the public that the public maintains control [of the development and operation of the facility]. No payments may be made to the private entity if public standards aren't met."

Communication

Fits and starts in the process are only pitfalls for the first several years of P3 implementation. During this initial phase of unfamiliarity, it is difficult to get the private agencies and public entities to speak the same language on issues such as risk transfer. Private entities are primarily concerned about the financial risk, whereas the public agencies have broader concerns, including political risk.

As Garvey also states, "The public and private can sometimes look at the same issue and see different things. The private side may not understand the challenges the public official is facing." It is therefore sometimes necessary for the public agency or private entity to retain a consultant familiar with P3s who can help the parties achieve the same perspective. The better the parties can communicate on the same level without misunderstanding the other side's perception, the smoother the process.

Assemble a Team

It is critical for the private enterprise to assemble a team that understands both the nature of developing the specific type of facility and the local political climate. An ideal team should consist of:

1) A developer with expertise in the type of facility at issue;

2) An operator with expertise in the type of facility;

3) A lender willing to underwrite the costs of design, construction, and operation;

4) A consultant familiar with the local politics and established relationships with decision-makers;

5) A talented forecaster to help foresee the project's financial and political performance over several decades; and

6) Legal counsel to establish the framework for the plan, draft the appropriate legal documents, and help maneuver through the P3 process.

The P3 process is long and arduous and requires advocacy and stamina to convince public decision makers that a P3

Rise of P3s in the U.S.

Although P3s have been gaining tremendous popularity in the U.S., the idea is hardly new. P3s have been the standard project delivery method for public construction in Europe and Canada for generations.

Until recently, public agencies in the U.S. had never needed to look to alternative funding sources to meet their facility and infrastructure requirements. However, the recent restriction in funding has created the need for an alternative solution.

First implemented on a mass scale in the U.S. with the construction of roads and transportation infrastructure, the fastest growing non-transportation sectors in P3 construction have been university facilities, mixed-use development, parking garages, and stadiums. Other examples include courthouses, police stations, jails, and water treatment plants.

model is appropriate. The team must be able to anticipate all the opponents to the deal, understand their positions, and prepare appropriate counter-positions. While the team leaders dedicate their time to the multi-year political process of getting P3 approval, CFMs must continuously monitor fluctuations in costs and availability of materials and labor to ensure they have not changed so markedly as to no longer render the project profitable.

Criteria & Procedures Among States

The lack of uniformity from state to state in the procedures for processing P3 projects, as well as from agency to agency within a state, frustrates the private side more than the public.

Some states, such as Virginia and Texas, have passed legislation endorsing this type of project delivery method, with similar legislation pending in Florida. Those statutes seek to increase uniformity in the manner in which P3 projects are processed. Other states stop short of outright endorsement and provide for a more conservative recognition of P3 projects. National P3 lenders tend to gravitate toward states with enabling P3 legislation when making investment decisions, as state legislation suggests a level of stability and support for P3 delivery methods and provides some modicum of uniformity among government agencies within that state.

This proliferation of state legislation helps, but the statutes are not uniform and do not provide the level of detailed guidance required to facilitate uniformity. This creates a number of problems. Private lenders are ~~weary~~ wary of investing in P3 projects in states that have not endorsed P3 as a delivery method by statute. In those states, the P3 process is often longer and more difficult, frustrating, costly, and uncertain when the public agency is unfamiliar with P3 projects.

As Garvey observed, "Every public entity is unique. Each state has its own peculiarities. We're not looking for uniformity so much as a consistent framework for the criteria and procedures involved (e.g., clarity of contract and procurement procedures, transparency, and centralized decision-making). Understanding public goals. What they are trying to achieve. Is the project critical to the community? We won't do jobs where the importance changes depending upon who is in office, like stadiums. We must think long-term." The good news: As more P3 projects are completed in the U.S. and news of their success spreads, the more predictable and acceptable they will become.

Risk Assessment/Proper Forecasting

Finally, not all P3 projects perform well financially. Most of the time, the failure is due to an incorrect risk assessment performed at the outset of the project, incorrectly anticipating returns and performance levels over the operations period. The project's economic viability is critical to ensuring an appropriate ROI for the private entity, but is also difficult to measure. Forecasting, more than any other component of the P3 project, can make or break a deal for a private developer and lender. Great care should be taken to ensure the most qualified forecasters are part of the project team at the outset of negotiations before a P3 project proposal is submitted to the public agency.

Conclusion

P3s could be the magic bullet public entities need to continue to deliver and maintain public facilities and infrastructure during a time of financial budgetary crisis. However, they are not appropriate for every job. Public perception must be measured to gauge acceptance of private participation in the delivery of the project. A careful cost/benefit analysis must be performed, with great attention to forecasting the project's anticipated performance over the multi-decade operations period.

For those able see it through, the rewards more than justify the means, as illustrated by the rapid growth in P3 projects and statutes across the country. P3s are the future of public construction in America. For those contractors that are prepared, it is the dawn of a new era; those that wait to see how things transpire may find themselves trying to catch up. ■

LEE A. WEINTRAUB is a Shareholder at Becker & Poliakoff, P.A. in Fort Lauderdale, FL, and specializes in construction law and commercial litigation. He represents owners, developers, contractors, subcontractors, bond sureties, and many others in the construction industry.

Lee is a longtime author for *CFMA Building Profits* and presented at CFMA's 2012 Annual Conference & Exhibition. He belongs to the South Florida Chapter and has served on its board of directors. Lee is board certified as an expert in construction law by The Florida Bar and belongs to The Florida Bar's Construction Law Committee as well as the Construction Owners Association of America.

Phone: 954-985-4147
E-Mail: lweintraub@becker-poliakoff.com
Website: www.becker-poliakoff.com