Construction DIVE

P3s: A growing alternative with potential to capitalize on 'privatized innovation'

By Kim Slowey
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It seems like every day, the industry implements more construction projects — particularly in the realm of infrastructure — using the public-private partnership (P3) model, and advocates say a P3 executed effectively can produce a win-win for everyone. A government entity, which might be cash-strapped, gets to see long-awaited projects completed thanks to an injection of private capital, and the joint venture or consortium executing the project receives the benefit of a long-term revenue stream in the form of tolls, admission fees or other payoffs involved in the operation and maintenance of whatever facility they built.

According to a Moody's Investors Service report this month, the U.S. market for P3s is ripe for growth and could become one of the world's largest. The use of P3s has been sporadic thus far, but Moody's found that important factors like available government resources, political support, a strong capital market and the legal structure necessary to enforce P3s will continue to benefit the delivery model.

But what exactly qualifies as a P3? And what stands in the way of wider implementation of the growing method?

An ambiguous definition

The term P3 has been thrown around so loosely that people might begin to wonder if just about any public-private relationship qualifies. Attorney Lee Weintraub, chair of the public private partnership practice at Becker & Poliakoff in Florida, said the traditional and most familiar P3 model will typically see a government entity hire a group from the private sector to design, finance and build a public bridge, road or other such project. That group will then operate and maintain the facility for as long as decades before turning it back over to the owner.

However, the term public-private partnership only requires an agreement between the public and private sector to deliver a project together, which leaves the definition wide open to interpretation, according to Weintraub.

"There are just so many different ways that these things take shape," Weintraub said. "There are an infinite number of variations on the theme."

Attorney Carol Patterson, senior partner of Zetlin & De Chiara LLP in New York, said the P3 structure is still in an "embryonic" phase and that even though common approaches exist, there are too many variables in each project to lump them all into one category.

But how far away from that traditional model of a P3 can the parties get before it's not a P3 anymore?

"For these deals to work, it has to be an 'everybody wins,'" Patterson said. "From the developer standpoint, there has to be a cash incentive that is going to be profitable, and, from the public authority standpoint, they want to know that the task they need to accomplish — whether it's a new bridge or library — is going to be developed, properly built and maintained."

Benefits of the model

It is in this area of profitability that P3s hold so many benefits, and proponents say their ability to assist in bringing a project in under schedule and in a more cost-effective manner is a significant factor.

Using Texas as a model, Larry Casey, executive vice president at Skanska USA, said the Lone Star State has invested more than $18 billion in roads using P3s and that, without exception, those projects came in 10% to 20% faster and less expensive than a traditional model.

However, both Casey and Weintraub caution that cost savings don't equate to cost cutting.

"Some people mistake the fast-tracking element (of P3s) as a detriment to the project, and that's not true," Weintraub said. "The same company that's rushing to complete the construction is the same company that has to maintain the facility, usually for decades, so they will design and construct it in a way that will reduce maintenance costs because that's how they make their money. If maintenance costs go up, it eats into their profit."

And this, according to Weintraub — who helped draft Florida's P3 statute — is another area where the owner benefits as well. "When it goes back to the public sector for operating, they are the beneficiary of (efficiency in construction) because those low maintenance costs perpetuate, and what the public sector pays will be a lot less than it would be under a traditional procurement," he said.

Casey said of the P3 process, "It's not about cheap or low cost, but it is about cost certainty, and it is about schedule certainty." He added that P3s also shift the risk of the project from the public sector to the private sector, which is a significant benefit.

Weintraub said the owner of a P3 can transfer the risk of higher construction costs to the private sector, as well as that of approximately 30 other types of inherent risks present in the design phase on through construction, financing, operations and maintenance.

Weintraub added that another benefit of P3s is being able to tap the private sector to solve design and logistics problems beyond the experience of many public agencies. He cited the example of a Florida highway where the P3 was charged with creating reversible lanes. Weintraub said the private piece of the P3 team came up with traffic control solutions that impressed even the Florida Department of Transportation.

"In the private sector, there's a lot of innovation that the public sector hasn't even thought of because that's not their realm, and I think you're going to see P3s used to take advantage of a lot of that privatized innovation," said attorney Jennifer Drake, vice-chair of the public private partnership practice at Becker & Poliakoff.

Regulations catching up

But, as expected in any situation when there is a significant change in the way an industry does business, state lawmakers are having to work overtime to catch up to the trend and enact appropriate regulations.

This is an area in which the Associated General Contractors of America has testified before various governmental panels regarding the use of P3s. "We are advocates for any revenue, funding or financing for infrastructure projects," said Sean O'Neill, director of congressional relations, infrastructure advancement, for the AGC.

And while the AGC said the P3 model is "critical to bridging the gap" in state and federal funding as a financing tool for critical transportation projects, the organization maintains that P3s are no replacement for direct federal funding. "We need to ensure, that for all types of infrastructure, there's a long-term sustainable funding source for, in this case, our federal transportation programs," O'Neill said.

O'Neill acknowledged that P3s, particularly in transportation projects, allow states to leverage funds for other projects when government funding is low and also helps them minimize upfront costs of borrowing, but said that dedicated funding continues to be the most important contribution that government at all levels can provide.

O'Neill said that as far as state regulations enabling P3s, individual AGC chapters are working in their own states to further those regulatory endeavors.

Casey said there are 33 or 34 states that have enabled legislation allowing P3s at the state level, and many local authorities have their own P3 or "alternative delivery" legislation as well. He said that getting everyone on board as far as regulation will take time, but that interest in P3s is really "opening up" across the country.

Obstacles to wider use

Nevertheless, aside from the regulatory front, what other barriers, if any, are hindering wider implementation of P3s?

Weintraub said that currently, the biggest obstacle to the wider use of P3s is a "lack of understanding and familiarity on behalf of the public sector."

"The biggest problem right now is that a lot of the public sector still doesn't understand it," he said. "It's a new concept. It's hard to get your arms around it the first few times." Using his own state as an example, Weintraub called Florida the "wild, wild West" when it comes to P3s, with agencies playing stop and go with procurements and creating a level of uncertainty for potential bidders along the way.

In addition to educating themselves through trade associations, which offer seminars and other materials to help public agencies gain understanding of the P3 process, Weintraub said that every public entity would benefit from trade consultants who can guide them through the process and add to the agency's credibility, particularly if the consultants are respected in the P3 world. He said agencies also need a champion for the project itself — someone who can convince the public that a P3 is a good thing and not the privatization of public services.

Casey agreed with Weintraub about the concept of a project champion. "What a project really needs is an internal public authority figure like a mayor to take on that task," he said. "It's that public official the taxpayers are going to look to for confirmation that this is a viable program."

A solution to a growing crisis?

Of course, the increased use of P3s might not even hinge on benefits, but pure necessity.

Casey said many municipalities and local governments are just now recovering from the recession and don't have the financial capacity to come up with the massive amount of funding required to tackle big projects. He added that an estimated $3.6 trillion will be needed by 2020 just to maintain the nation's existing infrastructure.

"There's going to be a real need to leverage both public and private funding to do this work," Casey said, "and a P3 is a terrific way to get it done."