THE NATIONAL COUNCIL FOR PUBLIC-PRIVATE PARTNERSHIPS

Public-Private Partnerships 101

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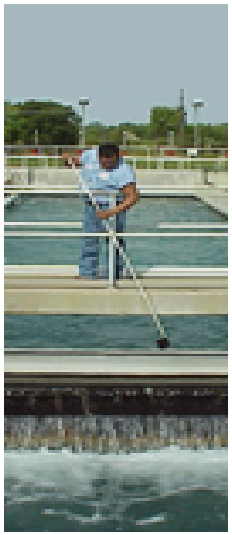
A Perspective on PPP Projects



- Partnerships involve a spectrum of arrangements
- Our focus = public-private partnerships
  - A "collaborative enterprise" of public and private parties
- **NOT the same as "Privatization"**
  - Difference = **the level of public control & oversight**

What is a P3?

P3 Defined

- A Public-Private Partnership (P3) is a contractual agreement between a public agency and a private entity that allows for greater private sector participation in the delivery and (in some cases) financing of a project.

- P3 provides:
  - Role for the private sector in solving public challenge
  - Variety of contract structures + financing
  - Performance-based outcome-focused approach.

P3 v. Traditional Procurement v. Privatization

TRADITIONAL DESIGN-BID-BUILD (DBB)	• Public agency retains ownership • All phases of work occur sequentially and under separate contracts • Public agency retains all project risks • Public agency responsible for financing • Focuses on price to achieve a defined scope
P3	• Public agency retains ownership and substantial control, but transfers responsibility for D/B/F/O/M to private partner under a single contract • Contracts may be long-term (often 20-99 years for DBFOM) • Phases of work, such as design and construction, may overlap • Public agency shares or transfers some project risks to private partner • Focuses on “best value” and “performance”
PRIVATIZATION	• Ownership and control of facility is transferred to private sector

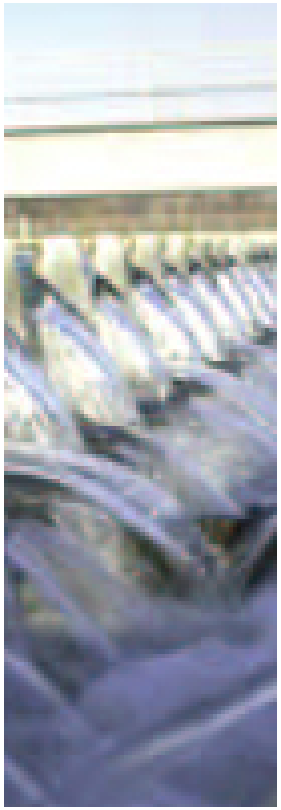
Why Consider P3: States & Municipalities Are Facing New Challenges

- Aging Infrastructure
  - Maintenance
  - Replacement & Expansion
- Regulatory or service demands for major facility improvements
- Shrinking budgets
- Pension shortfalls
- Constituent demands

PPPs = a possible answer (a tool in the toolbox)

An Example – Water And Wastewater

- Increasing challenge of meeting regulatory requirements (*for systems large and small*)
- Capital costs of expansion/upgrade are high
- Concern for predictability of long-term costs
- Concern for finding/retaining skilled workforce to maintain facilities
- Advantages of PPP:
  - *Design/build* can save considerable capital $
  - Long term management contracts can bring expertise to the table and stabilize O&M costs
  - Design, build, finance arrangements provide access to capital for required improvement
  - Lease/concessions may provide infusion of $ to help meet other community needs



Sectors Where P3 Has Been Used Effectively

Sectors	Revenue-Generating	Social Assets
• Transportation (including transit, roads, bridges, tunnels) • Water and Sewer • Energy • Public Facilities	• Parking Systems • Toll Roads, Bridges, etc. • Water and Sewer Systems • Airports (and facilities) • Ports • Solid Waste	• Schools • Courthouses, Jails • Civic Centers • Hospitals • Other public assets that do not generate revenues to be self-supporting

- Other sectors: (amusement) parks, broadband, convention centers, entertainment venues
- Energy saving projects
- Hybrid real estate developments (e.g., Chicago Union Station)

*from Tom Lanctot, William Blair, 2012

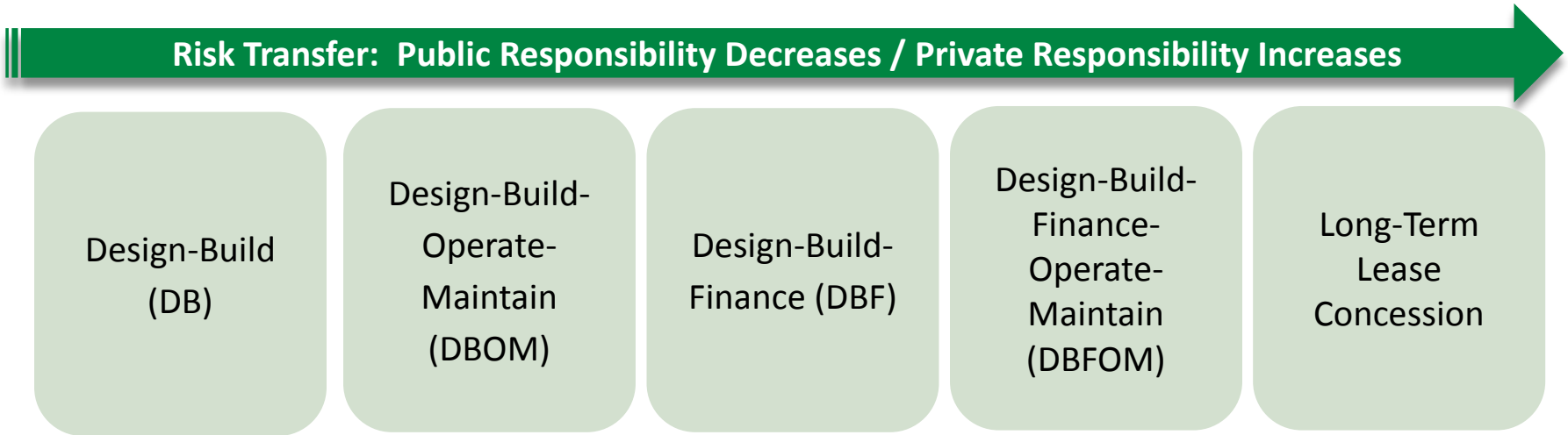
Key Criteria For Partnerships Irrespective Of Structure

- Enabling legislation in place?
- A genuine pressing need – does the public really want this project?
- Reasonable development timeframe?
- Financially feasible (public, user fees, etc.)?
- Manageable and shared risks
- Political climate
- Public sector procurement path
- Market evaluation
- Environmental evaluation
- Solid partnership philosophy

How Do P3 Transactions Differ From Traditional Procurement Process?

- Long-term arrangements require long-term partnering approach to managing and allocating risks
- Traditional procurement focuses on a single factor = price to achieve a defined scope of work / design (e.g., design-bid-build)
- P3 procurement requires request for proposal process and consideration of multiple factors to determine “best value”:
  - Contractor experience and reputation
  - Financial capability to sustain performance
  - Understanding and approach to meeting long-term objectives
  - Risk allocation
  - Both capital cost and long-term O&M costs

P3 Structures Come In A Spectrum



O&M Contract Structure

Customers

- Pay fees for services provided

O&M Contract

Public Entity

- Finances infrastructure (tax exempt bonds)
- Procures design & construction separately
- Sets & collects rates
- Engages O&M management entity

O&M Contractor

- Provides full operation and maintenance services
- May provide major repair and replacement services (fixed fee or from special fund allowance)
- Accepts significant operating risks

O&M Management Contract

Advantages:

- Contractor commits to provide services to performance standard
- Contractor accepts risk of managing certain costs (e.g., labor, commodities)
- Brings expertise to project (not just relying on own staff)
- Professional asset management – predictive and preventative maintenance
- Cost predictability & stability
- Economies of scale with respect to purchase of commodities
- Broader career opportunities for employees
- Improved risk management

Challenges:

- Parties must allocate risks thoughtfully
- Institutional barriers – procurement laws
- Owner relinquishes some control
- Compliance with rules governing tax exempt bonds (Rev. Proc. 2016-44) – expanded safe harbor
- Process for accommodating future capital improvements and changes in service requirements
- Exit condition requirements and tests

DBOM Structure

Public Entity

- Finances infrastructure (tax exempt bonds)
- Procures unified DBOM contract
- Sets & collects rates

Customers

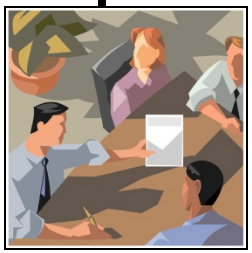
- Pay fees for services provided

Design-Build, O&M Contractor

Design-Build (D-B) employs a single point of responsibility for final design, construction and operation of facilities

Trade Subcontractors

Suppliers



Professional Consultants

Design/Build, Operate And Maintain (DBOM)

Advantages:

- Single point of responsibility
- Owner freedom from coordination between A/E and constructor
- In DBOM, no “who’s at fault” debate between design engineer, constructor and operator
- Savings – both schedule & cost
- Rewards innovation
- Improved risk management

Challenges:

- Parties must allocate risks thoughtfully
- Institutional barriers – procurement laws
- Owner relinquishes some control
- Availability of insurance & bonding products
- Need to pick contractors carefully

Risk Issues In DBOM

- Risk allocation requires careful parsing and definition, thinking about potential future issues and conditions
- Risk allocation with D/B subcontractors
- Risk of liability for mistakes is larger in DBOM than typical EPC contract, because operator essentially assures performance for entire operating period. Shortfalls in performance become magnified over time.
- Team members are critical – not just designing and building to meet performance criteria and an acceptance test; operator is accepting longer-term risks associated with operating parameters and durability.
- Public agency termination rights

DBFM Structure

Customers

- Pay fees for services provided

Public Entity

- Procures unified DBFM contract
- Sets & collects rates
- Pays service fee that includes component to repay capital financed by contractor

Design-Build, Finance, O&M Contractor

Lenders

- Provide financing via loan to DBFOM Contractor

Design Build Finance Maintain (DBFM)

- Similar to DBOM in structure, but contractor also provides financing for the new facility or facility improvements – raising potentially significant issues concerning security of investment, and enforceability of obligations to recover funds owed for privately-financed public improvements
- Varying forms of revenue / payment structures:
  - Tolls / collection of rates from consumers (parking/transit/highways)
  - Payment by government
    - Base fee
    - Fees / bonuses based on “availability” and performance (with or without maximums)

DBFM Issues

- From financing party's perspective: how to secure loan – bankruptcy or default risk
- What happens if government changes its mind?
- Restrictions on / or compensation for development of competing infrastructure (e.g., alternative transportation routes/methods / alternative parking structures)
- How to assure setting and collection of adequate rates to pay for O&M and capital recovery (enforceability of rate covenant)
- Who "owns" the improvements – depreciation and other tax issues

Lease / Concession Agreement Structure

Customers
- Pay fees / tolls

Investors
- Equity investment

Lenders
- Debt financing

Public Entity
- Grants 20-75 year concession arrangement
- Grants lease/easements for facility
- May set & collect rates
- Pays service fee that includes component to repay capital financed by contractor

Project Company
- Pays concession fee to public entity (upfront / over time)
- Arranges for financing of capital improvement
- Commits to O&M, repair and replacement during term

Contract Operator
- Long-term O&M contract with Project Company
- Paid service fee by Project Company

Lease And Concession Arrangements

- "Concession" is a term often used loosely – must define the "structure"
- Typical structure: a long-term lease of a public asset by a private operator, usually in consideration of an upfront concession payment (*e.g.*, pre-paid rent) or payment over time (set value or % of revenues)
- Private entity is responsible for operations, maintenance, design and construction
- Private entity may be required to finance and undertake near term and future capital improvements
- How private entity is paid:
  - Private entity allowed to set and collect rates within certain parameters (examples: turnpike leases and parking system leases)
  - Public entity may set and collect rates from consumers, paying private entity a service fee over term of lease (examples: water and wastewater systems)

Concession Arrangement Issues

- Legal authority of public entity to lease facilities or grant concession
- Defeasance of outstanding tax-exempt bonds
- Authority / limitations on uses of concession payment
- Financing issues: ability to mortgage leasehold interest
- Changes to facility tax status / exposure to new state & local taxes
- Regulatory issues
- + Most of DBOM type risk issue

Concession Agreement Issues

- Project financing concerns:
  - Breadth of financing commitment – near term known projects vs undefined improvements later in concession term
  - Assurance of clear stream of payments back from public entity
  - Security for investment/loans meeting expectations of investors/lenders
  - What happens to pre-existing infrastructure debt – must it be defeased?
- Requires “marriage” of capital market financing and operation expertise for particular infrastructure type
  - Experience and reputation of operator
  - Relationship between operator, project company, investors & lenders

Concession Agreement Issues (cont'd)

- Who sets the rates, and subject to what controls?
  - Raising rates, allocating costs between user classes is a hot political issue
  - If public entity sets rates, what covenants are imposed re setting adequate rates and how are such covenants enforced?
  - Concessionaires may prefer to have control over setting rates within defined bounds
  - Legal setting may limit ability to delegate rate setting
  - Entities not used to establishing and committing to rates over long term
  - Potential for public referendum/initiative
  - Restrictions on use of funds (e.g., California Proposition 218)
- Who collects the rates and controls disbursement of funds?
  - Concern over accountability and potential for diversion of funds to other uses
  - How to allocate revenues between concessionaire and public entity where public entity retains certain risks and responsibilities
  - Lock box, escrow and waterfall arrangements

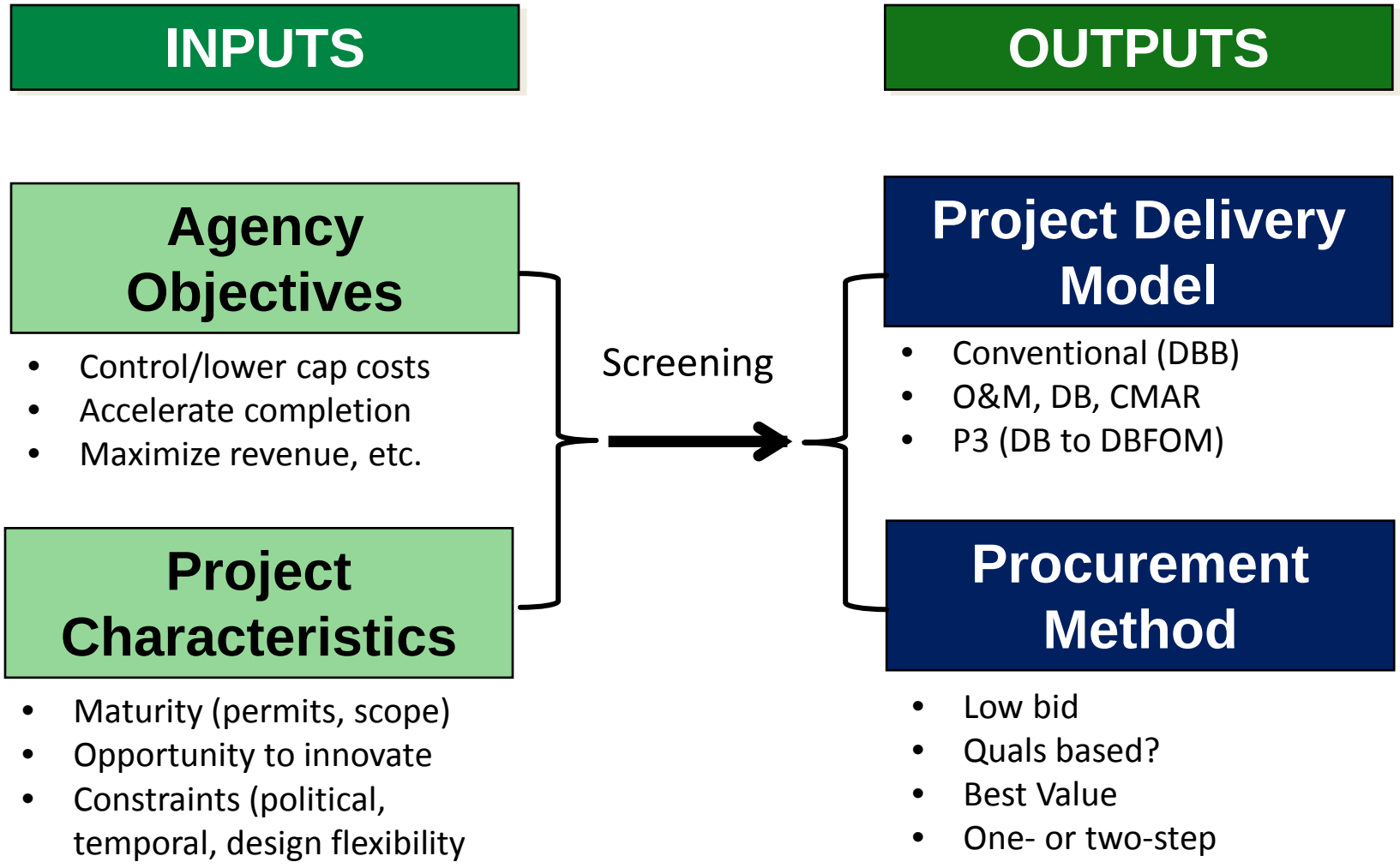
Basic Considerations

- What are the public agency's objectives for the project or service? (scope, quality, cost, timing)
- What is the agency's legal authority for entering into various types of P3 transaction forms?
- What procurement procedures apply, and do they allow "best value" selection criteria?
- What revenue stream is contemplated to cover P3 cost recovery?
- Will the type of project or service arrangement benefit from risk allocation and sharing between public and private partners?
- Value of P3 approach vs. transaction cost of P3 approach

First Steps

- Enabling legislation (market, transparent, works)
- Internal champion with protection, power, credibility
- Implementing regulations
- Internal structure, responsibilities (e.g., relationship of districts/departments to one another; financing authority)
- Develop institutional capacity with complementary team of trusted advisors – interdisciplinary!
  - financial, technical, legal
  - planning, operations, risk management, insurance
  - market analytics
- Build program (guidelines, rules of the road)
  - Unsolicited proposals
- Build project-screening process

Identifying & Developing A P3



Identifying & Allocating Risk

- Risk shifting is key purpose and feature of P3s
  - Private sector has more control and responsibility
  - Integrated functions (mitigate risk; create efficiencies)
  - Spread of risk over time
- Private Partner prices its risks
  - VfM: paying to transfer to expert who can (best) manage
  - Macro-economic risks, project risks, participant risks
  - There are market-tested allocations; know them
- Allocate to party better positioned to manage; or share
  - Or spread to third party (e.g., insurers)
- Risk Management Best Practices

Thoughts On Procurement

- "*What are we trying to do here*"
- Public Sector habits: quality, no risk, specificity, low price
- Private Sector wants: payment certainty, capped risks, transparency, full public/political buy-in
- P3 procurement and negotiation:
  - Focus on performance (rather than specificity)
  - *Priceable* risks
  - *Reliable* payment stream
  - *Reduced* political risk – think statutory solutions befc
  - Partner attitude
  - Chance at the upside
- Guiding principles lead to **procurement best practices**

More Thoughts On Procurement

- Industry Days; RFIs
- Qualifications
- Draft Documents with Proposal instructions
- Hard look at regulatory, conventional requirements
- Industry Review during Procurement, with one-on-one's
- (example benefit:) ATC process (there are others)
- Segregated financial and technical evaluations
- Stipends
- Stick to the published schedule; anticipate time to coordinate project financing, development and negotiating P3-specific terms contracts

What P3 Can Do

- Tap private sector expertise, depth of experience, innovation, investment (financial + enhanced incentive to manage and oversee)
- Reduce capital and O&M cost by applying private sector expertise and economies of scale
- Accelerate completion (over traditional delivery)
- Offer financing efficiencies (access to capital, reduced initial public investment)
- Achieve lifecycle cost efficiencies, “handback” at prescribed condition / bring financial resources for communities with limited access to capital
- Optimize risk allocation (transfer some to private sector)
- Reduce interface risk
- Reduce personnel costs, modern retirement systems, provide broader career path for employees
- Help monetize public assets to assist in meeting other financial challenges

What P3 Cannot Do

- Rescue a poorly conceived or planned project
- Provide funding where long-term revenue or repayment stream is undefined or uncertain
  - Equity investment wants a rate of return
  - Debt investment interest pays for risk assumption
- Transfer all project risks to the private partner
- Allow the public sector to walk away at completion ("toss the keys"); public sector contract administration monitors performance
- Entirely avoid claims – P3s are like a marriage;
- Avoid front-end efforts, necessary foresight and time investment
- Avoid out-year effects of programmatic, legal changes – public sector must be prepared to honor untransferred out-year risks

Examples Of The Broad Scope Of P3 Transactions At Municipal & State Level

- Water and wastewater
  - City of Rialto (Rialto City / Rialto Water Services)
  - City of Allentown (Allentown/Lehigh County Authority/KKR)
  - Tampa Bay Water
- Stormwater – Prince George's County, MD community-based P3
- Transportation
  - Highways and mass transit – VA, FL, MD, TX, CA, PA
  - Transit oriented development
  - Airports
- Public services
  - Maryland interstate service plazas

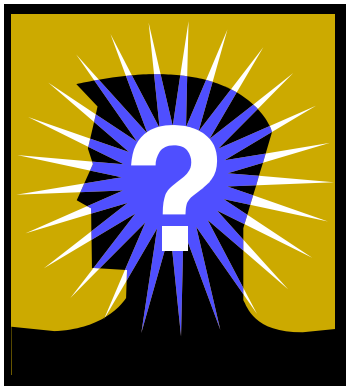
Examples (cont'd)

- Housing
- Public buildings
  - Long Beach Courthouse
  - Long Beach Civic Center
  - Arizona agency buildings
- Energy & energy efficiency
  - White Oak (GSA/FDA/Honeywell)
  - Devens Solar (Mass Development Finance Agency / EBZ Solar)
  - Street lamp replacement projects
- Waste and recycling
  - ReCommunity Recycling (Resource Recovery & Recycling Authority of Southwest Oakland County)

Key Takeaways

- P3s are a viable tool for cost-effective implementation of a wide range of infrastructure projects and public service efforts
- P3 is a “marriage”
- P3s are not “free money”
- Defining objectives is critical
- Focus on performance measures
- Markets matter / lenders & investors matter
- No definitive dollar threshold, but must be sufficient to justify transaction costs associated with P3 procurement and negotiations
- ***No magic formula => successful implementation requires creative and thoughtful approaches, with an eye to the long-term and best value to the public***

Questions?



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