Considerations for Public-Private Partnerships

A joint report from the National Association of State Procurement Officials, the National Association of State Facilities Administrators and the National Association of State Chief Administrators

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National Association of State Procurement Officials

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NATIONAL ASSOCIATION OF STATE FACILITIES ADMINISTRATORS

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National Association of State Chief Administrators

Purpose

As government officials who oversee procurement, facilities and other administrative functions for state governments, we are often asked to weigh in on the merits of various proposals for public-private partnerships (P3s).

Our experience shows us, though, that the success or failure of those arrangements depends a great deal on the details of those projects. We have seen truly innovative projects that used private sector involvement to accomplish what government, by itself, could not. On the other hand, we have seen projects that have not benefitted the public because of how they were structured.

We convened a meeting of the leaders of our organizations to share our experiences and develop principles that our members — as well as other policymakers — should consider when evaluating, developing and maintaining P3s. This paper is the result of those discussions.

What is a Public-Private Partnership?

Governments work with the private sector in countless ways to provide public services. The central idea of P3s, however, is that the interests of the parties are aligned. There are many good definitions for the exact nature of public-private partnerships, but even experts disagree on details such as whether the private partner needs to invest its own capital for the arrangement to qualify as a P3. For the purposes of this document, we will use the definition of P3s outlined in *Governing's* "Guide to Financial Literacy: Understanding the Risks & Rewards of Public-Private Partnerships," which simply defines a P3 as "a long-term agreement between a government and the private sector to share the risks and rewards of delivering an essential public service."

With P3s, a government can allocate (i.e., shift) some or all of that risk to the private partner(s). But keep in mind that risk allocation is not free. Private partners will accept risk, but only in exchange for higher payments, more control over setting fees or tolls, or some other concession. For governments, the central challenge in P3s is knowing which risks to keep, which to allocate and which to share. Table 1 to the right shows the P3 risk matrix — or the risks inherent to most P3s — and which party is typically best able to manage those risks.

When are P3s Worth Considering?

Although P3s can be beneficial, they are not appropriate for every circumstance. Public officials should be cautious to make sure they are not using P3s in cases where:

- ✓ The added expenses of using private capital, rather than public (tax-exempt) capital, is not offset by lower life cycle costs or other benefits
- ✓ The arrangements are simply a way of legally obligating a public entity to spend money it should be spending already (such as on preventive maintenance)
- ✓ The deal would take away a core function of government from public oversight or control

It is worth noting that Virginia, a national leader in the use of P3s, declines four out of every five P3 proposals that come to it, according to Douglas Koelemay, director of Virginia's Office of Public-Private Partnerships. He says those projects are most often rejected because they aren't a priority for the state; the relevant agency doesn't have the capacity to manage the project; the project does not add value; or the idea is unproven.

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When conducting a cost-benefit assessment of a potential P3, public officials should make sure they have complete, reliable data on the total cost of ownership under the current arrangement. For example, cost comparisons might show how much the government could save by issuing its own (lower-interest) tax-exempt bonds instead of using higher-interest private financing. But the analysis could also show the higher long-term costs of hiring government employees (including their retirement and other benefits) instead of relying on the work of employees in the private sector.

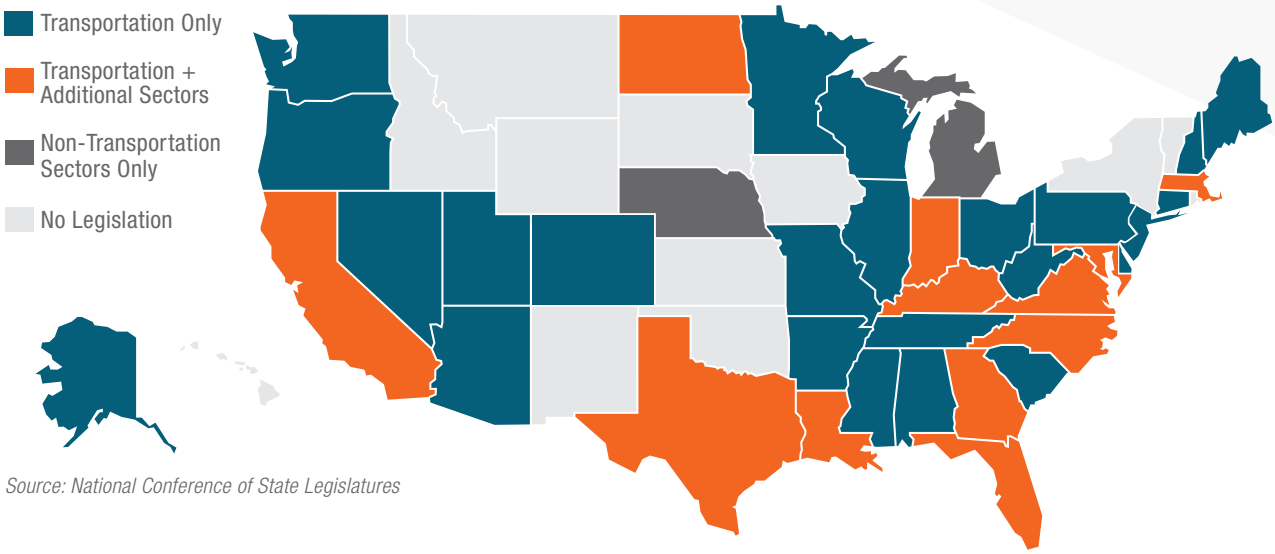
Often, the most transformative P3s come when governments use them to accomplish a task that is not a core function of government. The City of Long Beach in California is pursuing a P3 that would transform its downtown by building a new city hall

Table 1: Typical P3 Risks

RISK	PUBLIC SECTOR	PRIVATE SECTOR	SHARED
Regulatory/Policy	●		
Planning and Design		●	
Permits and Approvals		●	
Construction		●	
Operations/Maintenance		●	
Finance/Market		●	
Private Sector Default		●	
Political			●
Force Majeure			●
Demand			●

Source: Governing's Guide to Financial Literacy: Understanding the Risks & Rewards of Public-Private Partnerships

States With P3-Enabling Legislation



Source: National Conference of State Legislatures

and port authority headquarters, creating new parks and adding mixed-use development. Likewise, Kentucky has used a P3 to extend broadband access to underserved rural areas.

P3s are also attractive when they meet a pressing need that could not otherwise be addressed. When Kentucky faced a sudden office space shortage (because its offices were being converted back to bourbon warehouses), the state used a P3 to quickly erect a new office building for its displaced employees. It took about a year and a half from the time the builder started construction until workers could move in. Similarly, Prince George's County in Maryland is using a P3 to speed work on building green infrastructure to reduce stormwater pollution in the Chesapeake Bay. The U.S. Environmental Protection Agency required the county to convert almost 5 percent of its total area into surfaces that will either soak up or treat rainwater in the next decade. A private sector company will design and build that infrastructure rapidly, and then operate and maintain it for decades to come.

Practical Considerations

When carrying out P3s, government agencies should be mindful of dynamics that could directly affect the success of the arrangement.

Public engagement is key. P3s remain controversial in many quarters, particularly because of past arrangements that provided little long-term benefit for residents. But public input can better shape arrangements as well. Getting useful input often entails going beyond the public hearings that are commonly required under state laws. Before Transurban — a company that manages and develops urban toll road networks — built toll lanes in northern Virginia, for example, it conducted focus groups to discern what its potential users wanted from the new lanes and what drivers would pay to use them. Likewise, officials in Prince George's County agreed they wanted their green infrastructure improvements to be built by local workers in economically challenged areas. The resulting agreement provides the county with social and economic benefits, along with environmental improvements.

Public engagement should continue even after an agreement is reached, such as informing citizens about how new revenues are spent. State officials should also realize that even capable government lawyers and experts will likely be overmatched, in terms of expertise and resources, when negotiating P3s. Many — although not all — potential partners are large, multinational corporations. This can give them significant advantages in operating facilities or running programs.

But it also means that negotiations can seem one sided, even for smart and resourceful government employees. Government lawyers, for example, tend to be generalists, but their counterparts in the private sector are specialists. Those private experts also likely have several deals under their belts, while P3s are still a novelty for most U.S. government agencies.

There are, however, ways to ensure the public interest is being served. Most importantly, the government officials who must sign off on any agreements must come to the negotiating table with a clear idea of what their goals are for the P3. Before they sign off on any deal, they should look back to those original goals and verify the arrangement accomplishes them.

It is also helpful to research potential partners. P3s often last for a decade, if not longer, so it is important that partners can work well with you. Because P3s last a long time, it is common for issues to arise that will require changes to the original agreement.

Not all P3s are large-scale projects, and there is a good chance that agency officials will know some of the applicants. Fortunately, the larger outside companies have long track records. It is easy to find out what kinds of projects they have been involved in, how they have approached those deals and any problems that have come up in those partnerships. Just knowing the jurisdictions they are active in can come in handy. State officials should also make sure all affected state agencies have representatives at the negotiating table. A transportation agency building a toll road, for example, should include finance experts from the executive budget office in those talks.

States can help evaluate the merits of potential P3s by establishing a special office, modeled after Virginia's Office of Public-Private Partnerships, to help vet projects. It is important that this office offers objective advice, and is not evaluated based on the number of P3 projects inked under its watch. (The most recent federal surface transportation law, called the FAST Act, allows states to use highway money to fund P3 offices.) If a state does not have such an office, agencies can also ask to retain their own expert attorneys as special assistant attorneys general to help negotiate the deals. They can also consult with peers in other states (which can be identified by NASPO, NASFA and NASCA).

P3s and Procurement Laws

Often, states allow agencies to use different procurement standards when negotiating P3s than they would have to follow for other types of contracts. This can be helpful. States commonly require agencies to select the lowest bidder for a project, but that is not always the best approach for selecting a long-term partner for a P3. Agencies picking a partner for a P3 might also want to consider vendors' expertise, track record and ability to work collaboratively with government.

But avoiding normal procurement laws should not be the main purpose of choosing to use a P3 instead of a more typical arrangement. If agencies or government officials find the procurement process cumbersome, they and the rest of the public could be better served by fixing or updating procurement laws or regulations, rather than sidestepping them.

Some agencies with P3 experience advise that it is often helpful for agencies to issue a request for information (RFI) before issuing a request for proposal (RFP) for such projects.

State and local officials should also be mindful of IRS regulations that govern the use of facilities paid for with tax-exempt bonds by private, for-profit entities. (See, generally, 26 U.S. Code § 141.) These regulations are significant enough hurdles that they have prevented states from pursuing deals to lease access to communications towers in remote locations and from adding retail outlets in a downtown government-owned building.

Conclusion

Public-private partnerships can be a powerful tool to help governments accomplish tasks they could not otherwise complete. When structured properly, P3s can bring capital, expertise, efficiencies, innovation and protection from risk to the delivery of public services. But government officials must carefully consider whether a P3 is appropriate. When doing so, they should consult with the public to develop the main goals of a project. They should make sure the P3 is designed to accomplish those goals before agreeing to the project. And they must be willing to work with their partners long after the ink is dry on the contract to address new issues as they arise.

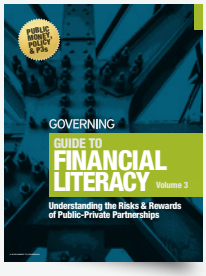
What Role Should Policymakers Play in P3s?

As a policymaker, your job is to build a skillset and nurture a mindset. The "skillset" is about getting the right technical expertise. Building that skillset starts with some specific steps you can help your jurisdictions take long before P3 opportunities materialize:

- Know how much infrastructure your jurisdiction can afford.
- Develop the right technical capacity, such as P3-focused staff members.
- Look for state resources such as P3 coordinating authorities, but be prepared to supplement public resources with independent expertise. Optimize your current, traditional procurement process.

The "mindset" is about anticipating and managing political conflict. Some specific strategies include:

- Define your jurisdiction's objectives and priorities for P3s — it's crucial to consider in advance the trade-offs P3s present and be willing to acknowledge or re-shape those trade-offs as necessary.
- Understand the relevant federal, state and local policy framework.
- Evaluate political feasibility early and often, including knowing how environmental impact statements, mandatory competitive bidding and other legal requirements affect your P3 procurement options.
- Engage the relevant stakeholders.
- Establish a formal, independent process to consider the benefits and costs of a P3 relative to some benchmark.
- Be transparent by sharing the best available revenue forecasts, cost estimates and (where possible) bidding information.



TO LEARN MORE about how P3s work and when they're right for your community, download *Governing's* "Guide to Financial Literacy: Understanding the Risks and Rewards of Public-Private Partnerships" at www.governing.com/papers.

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