

Washington State

Capital Projects Advisory Review Board

Public Private Partnership Committee

Summary Report of Recommendations and Draft Legislation

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P3 Committee Goal and Context

CPARB formed the Public-Private Partnership (P3) Committee in December 2014 with the charge to “Focus on public works and alternative delivery methods, evaluate existing statute, RCW 47.46 Public-Private Transportation Initiatives, Transportation Initiatives Partnership, and if existing statute isn't appropriate, draft proposed statutory language.” The P3 Committee convened beginning in early 2015 with this goal in view.

The Committee’s initial discussions evaluated and built upon two key sources. First, the Committee reviewed and discussed current Washington statutes addressing Public-Private Partnerships, particularly in RCW 47.46 (Public-Private Transportation Initiatives) and RCW 47.29 (Transportation Innovative Partnerships). The Committee’s initial work involved evaluating how these existing laws have been used—or more accurately, why they have not been used—concluding that the overall structure and specific limitations and features of the existing statutes effectively prevented the use of P3 methodologies. Among the limitations and impediments are a requirement for state-issued debt for all P3 projects, multiple stages of project review and possible termination after substantial initial investment by both public and private participants, and limited application to transportation projects only.

The P3 Committee concluded early in its work the existing statutes did not serve their originally intended purposes nor enable the effective use of P3 to deliver public benefit, and there are both opportunities for P3 methodologies to be used to provide value to the Washington public and demand within the public and private sector to participate in potential P3 projects in Washington. The Committee accordingly began developing new legislation to address the perceived shortcomings of the existing statutes and to enable P3 methodologies to be used on a variety of projects, including non-transportation and/or non-revenue projects, incorporating lessons from Washington and from other jurisdictions where P3 has been developed as a valuable tool in the public works toolbox.

Another important starting point for the P3 Committee’s work was a study and report commissioned by the Washington State Joint Transportation Committee (JTC), published by AECOM in January 2012, entitled “Evaluation of Public Private Partnerships.” The 280-page JTC/AECOM report provides detailed discussion of P3 concepts and case studies, summarizes the history and issues with the existing Washington statutory structure, and includes a variety of best practices and recommendations regarding potential future P3 legislation. The P3 Committee drew from the JTC/AECOM report in early discussions, and used the best practices and recommendations in drafting, revising, and reviewing the draft legislation as it was refined over the two years of the Committee’s discussions.

From 2015 to 2017, the P3 Committee drafted and refined its proposed legislation. The Committee’s drafting drew upon a wide variety of sources, including existing legislation from other states (e.g., Virginia, Massachusetts, Pennsylvania, Maryland, Texas, Arizona, Florida, and others), and a large volume of model legislation and best practices publications, including the National Conference of State Legislatures (NCSL),¹ Association for the Improvement of American Infrastructure (AIAI),² American Institute of Architects

¹ *Public-Private Partnerships for Transportation, A Toolkit for Legislators*, National Conference of State Legislatures, October 2010.

² *Best Practices Guide*, Association for the Improvement of American Infrastructure, January 2014.

(AIA),³ Design-Build Institute of America (DBIA),⁴ Associated General Contractors (AGC),⁵ National Council for Public-Private Partnerships,⁶ U.S. Government Accountability Office,⁷ National Association of State Procurement Officials (NASPO/NASFA/NASCA),⁸ National Cooperative Highway Research Program,⁹ and American Subcontractors Association (ASA),¹⁰ as well as various academic papers, including several drafted by P3 Committee members.

What emerged from the P3 Committee's discussions was a piece of draft legislation intended to make P3 delivery approaches available, flexible, and useful to public bodies on a variety of potential projects, while including safeguards for the public interest through open and fair competition, protections for Washington's high labor standards, select mandatory procurement and contract considerations, and provisions promoting participation by underrepresented and disadvantaged business interests.

The P3 Committee is submitting the draft legislation to CPARB with the recommendation that the Board endorse the draft to be submitted to the Legislature through CPARB's appointed legislative members, with the proviso that the P3 Committee remain available to provide further support to the legislative members regarding any desired refinement as the draft legislation is prepared for introduction as a legislative Bill.

Public-Private Partnership – Board Primer

A Working Definition

The JTC / AECOM report provides a useful working description of a Public-Private Partnership, which can be summarized as a performance-based contract between the public sector (any public body) and the private sector (usually a consortium of private sector companies working together) to arrange the financing, design, construction, and typically long-term operation and maintenance of a public facility.¹¹ In a typical P3 structure, the public body provides the property for the facility, sets design and performance requirements and restrictions, and establishes the method of payment for the construction and operation of the facility, which may draw on a mix of public funds, private debt, investment equity,

³ *Public-Private Partnerships for Public Facilities, Legislative Resource Kit*, The American Institute of Architects, November 2014.

⁴ Various resources compiled at <https://www.dbia.org/resource-center/p3-resources/Pages/default.aspx>.

⁵ *Public Private Partnerships*, AGC Online White Paper, available online at: <https://www.agc.org/public-private-partnerships-p3s-overview>

⁶ *7 Keys to Success*, National Center for Public-Private Partnerships, www.ncppp.org.

⁷ *Highway Public-Private Partnerships, More Rigorous Up-Front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, GAO, February 2008.

⁸ *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*, September 2016.

⁹ *NCHRP Synthesis 391: Public Sector Decision-Making for Public-Private Partnerships*, NCHRP Transportation Research Board, 2009.

¹⁰ *Public-Private Partnership Laws in the States, Including Surety Bond Requirements*, American Subcontractors Association, National Association of Surety Bond Producers, and Surety and Fidelity Association of America, 2014.

¹¹ *Evaluation of Public Private Partnerships, Washington State Joint Transportation Committee*, AECOM Report, January 19, 2012, available online at:

http://leg.wa.gov/JTC/Documents/Studies/P3/P3FinalReport_Jan2012Web.pdf

and/or revenues generated by the facility. The private partner is generally responsible for the facility's design, construction, and often long-term operation and maintenance of the facility, as well as full or partial financing. Of note, the property and improvements ownership is retained by the public sector, and control reverts to the public body after the contract term.

P3 models are used to deliver a variety of projects, including hospitals, roads (both tolled and non-tolled), transit systems, courthouses, airport facilities, water treatment facilities, utility infrastructure, school facilities, and various other public facilities. In practice, P3 is an umbrella concept that includes an array of possible variations based on the public body's financial needs, desired risk allocation, logistical and staffing capacity.

For some projects, a P3 approach may be a mechanism to use private capital to bridge funding gaps and expedite delivery of a needed public facility. For other projects, the public body's primary objective may be to shift risks associated with design and construction as well as long-term operation and maintenance.

Many P3 structures include performance-based compensation, with the public body setting performance standards and the private body's compensation based on a combination of fixed pricing, agreed rates, facility revenues, profitability, availability, volume, quality metrics, efficiency, safety, environmental goals, condition at expiry of the agreement, and other factors.

Given the varied potential contract and financing structures, a public body might enter into a Public-Private Partnership in which the distinguishing feature is that the private sector participant provides upfront capital for the project—through private equity investment and/or loans (often both)—while the project's delivery, operation, and maintenance are otherwise achieved through more traditional methods. Alternatively, a public body might structure a Public-Private Partnership to feature long-term performance-based compensation, thereby emphasizing project performance over time and shifting risks associated with future O&M costs. Such an arrangement, when coupled with appropriately defined performance requirements, may also be used to incentivize initial design quality, since the private sector participant will be responsible for the long-term performance of the facility and compliance with the public body's requirements over time.

In many cases, public owners have mixed needs and motivations, and use P3 arrangements simultaneously to lighten the initial financial impact of a major project, promote quality and speed of delivery, promote long-term performance objectives, and shift performance risks to the private sector in a way that aligns the public and private sector interests in the performance of facility. Some public owners also address concerns over staffing requirements to meet growing infrastructure programs, using P3 approaches to shift the responsibility of finding and allocating resources to a concessionaire to mitigate their own personnel bandwidth.

Specific P3 Methodologies

The precise structure under which the private sector participant is to design, build, finance, operate, and/or maintain the facility depends on the public body's priorities in terms of overall cash outlay, the timing of the public body's monetary obligations, performance needs, short and long-term risk allocation (in terms of both operational and financial performance), and resource availability.

The most utilized P3 models include the following:

Design-Build-Finance-Operate-Maintain (DBFOM).

In a DBFOM model, the private sector entity is responsible for design, construction, financing (typically through a combination of private equity investment and debt), and long-term operation and maintenance of the facility (road, bridge, hospital, courthouse, terminal, plant, system, etc.). O&M periods range from 10 to 50 years or more, with 30 - 40 years being common, as this encourages development of facilities with a longer asset life. In this model, the private sector works much like a private developer for the project, while the public body typically defines design parameters, performance requirements, rates and any tolls, and any other required features of the facility. DBFOM models are often categorized based on how the private entity will be paid over time:

DBFOM-Availability Model – In an “availability” structure, the public body makes periodic payments to the private entity based on defined rates and subject to performance parameters—that is, the public body pays for the facility being “available” and meeting contractual requirements. The facility may or may not generate revenue (through user fees, tolls, ticket sales, usage rates, etc.), and the compensation to be paid to the private entity may include performance incentives, which performance incentives are often in the form of deductions for non-performance. Examples could include a roadway keeping traffic moving at target rates or meeting specified safety goals, or a building meeting or exceeding energy efficiency requirements, or indoor environmental conditions being met.

DBFOM-Revenue Concession – In a “concession” structure, the private entity receives all or a portion of the revenues produced by the facility over time. A concession arrangement may be used as a mechanism to shift some or all of the risk of the project’s financial performance to the private sector—the developer only makes money if the facility produces revenue. Commonly, the revenue concession represents only a portion of the private entity’s compensation, and can be used both to defray the financial performance risks that would otherwise be borne by the public body as well as a structure to incentivize the private entity to maximize the facility’s financial performance, within parameters prescribed by the public body.

In a DBFOM model, the primary purpose of the private financing component may to meet the public body’s funding needs, or may be a mechanism to ensure the private entity is sufficiently invested and incentivized to ensure successful long-term performance of the facility.

Design-Build-Operate-Maintain (DBOM).

DBOM design-build construction delivery with long-term private operation and maintenance by the private partner. The public body defines the design parameters and performance requirements, and the private entity is paid for the construction and long-term O&M based on agreed rates and standards. DBOM is often used to enable the public body to utilize private sector expertise and efficiency in operating specialized facilities, and may be structured to incentivize design and construction quality where the private partner must design and build a facility that it is committed to operating and maintaining over a period of years.

Design-Build Finance (DBF).

In a DBF model, the project is delivered using a design-build methodology, with the private entity contributing some portion of the financing, through either debt or equity. The primary advantage to this model is speed of delivery, allowing the public to take advantage of private financing to fill funding gaps.

Design-Build-Finance-Maintain (DBFM).

Like DBFOM, a DBFM model uses private financing—whether to fill funding gaps, expedite delivery, incentivize long-term performance, or a combination—and holds the private entity responsible for physical maintenance of the facility, while day-to-day operation remains controlled by the public body.

Generally, program functions (eg clinical processes in a hospital, education and administration functions in schools and colleges, justice functions including clerical in a court, etc) are retained by the public sector.

The following chart provides a high level summary of the features generally involved in the noted models:

Project Attribute	DBF	DBOM	DBFM	DBFOM (Availability)	DBFOM (Revenue)
Date Certain Delivery	✓		✓	✓	✓
Price Certain Delivery	✓		✓	✓	✓
D-B Interface Risk Transfer	✓	✓	✓	✓	✓
DB - FM Interface Risk Transfer				✓	✓
Whole of Life Cost Considerations			✓	✓	✓
Maintenance Cost and Performance Risk Transfer		Partial	✓	✓	✓
Operations ¹ Cost and Performance Risk Transfer		Partial	✓	✓	✓
Energy Efficiency Performance			✓	✓	✓
Asset Condition during and at end of term Risk Transfer			✓	✓	✓
Sufficiency of funds (revenue generation to fund Project)					✓

Note¹ Operations refers to provision of services related to facility but are other than maintenance; eg Cleaning, landscaping, help desk, etc

Public bodies in the US, Canada, and Europe have used variations on these procurement models and others to meet a diverse mix of public objectives. Given the wide variety of possible structures—and the even wider variety of considerations for a given project in terms of financing details, public funding sources, performance security, risk allocation, performance needs, technical expertise, and ultimately value to the public—the CPARB P3 Committee concluded it was important to recognize a broad and flexible definition of a Public-Private Partnership, with specific limitations to ensure potential projects receive appropriate vetting, address key contractual issues, protect the public interest, preserve the state’s high labor standards, and promote fair competition and participation.

In many cases, the security package consists of traditional performance bonds or other security covering construction of the facility, coupled with performance-based contractual payment terms, and, in some cases, additional letters of credit, guaranties, or other security.

The P3 Committee's Draft Legislation

With these general considerations in view, the P3 Committee (the Committee) recommends that CPARB endorse draft legislation to be presented to the Legislature through its appointed legislative members, with the P3 Committee available to those members for consultation when refining and preparing the draft for introduction.

Below is a summary of key features, public policy considerations discussed by stakeholders, and mechanics of the Committee's recommended draft.

Overview

The Committee's draft draws from numerous sources, including statutes enacted in Washington and other jurisdictions as well as model legislation published by various public coalitions and private industry groups, in addition to the regional and national expertise of the Committee's membership and Washington-specific considerations.

In summary, the draft legislation proposes the following:

1. **Value-based procurement.** To procure a P3 project, the owner must use either a one-step Request for Proposals (RFP) process, or a two-step Request for Qualifications/Request for Proposals (RFQ/RFP) process.

The Committee notes that most P3 projects are procured using an RFQ/RFP process. The legislation outlines various requirements for the RFQ and the RFP, including various project parameters and draft contract terms. In addition to technical qualifications, past performance, and proposal value, the owner is required to include as an evaluation factor the proposers' plans for labor harmony and plans for participation by disadvantaged and underrepresented businesses.

Any honorarium must be specified up front, and any honorarium must be sufficient to generate meaningful competition and consider the level of effort required.

2. **Express "opt-in" requirement.** There are other means for some public owners to accomplish some of the ends this legislation enables. This legislation is not intended to affect an owner's ability to use any other existing avenue to implement projects, and only applies if the owner expressly elects to procure a project under this P3 legislation.
3. **Contract requirements.** Striking a balance between the flexibility needed for public owners to tailor P3 structures to their specific project needs and the desire to ensure basic public interest safeguards are in place, the legislation includes a list of P3-specific items that must be included in every P3 contract, including: basic project parameters and technical requirements; term (<50 years); property interests and compensation mechanics; any user fees and method of determination and modification; termination terms; security package; reporting; usage rights; payment bonds; prevailing wages; disadvantaged business participation plan; labor harmony plan; conditions upon expiration; and any project-specific restrictions (e.g. potential competing facilities).

4. **Public ownership.** Property remains public and control reverts to the public body upon expiration or termination of the contract. Public property involved in a P3 project is to remain public, with all rights, title, and interest reverting to the public body upon expiration or termination of the P3 Agreement.
5. **Flexible Funding and Financing.** The public body may combine private, state, federal, and other sources of funding and financing.
6. **Freestanding Requirements Regarding Subcontractors, Labor, and Disadvantaged Businesses.** The legislation includes a freestanding statutory requirement that every P3 contract must provide for, and the public body must otherwise ensure adequate provision is made for:
 - a. Payment of subcontractors, suppliers, and laborers, including payment bonds;
 - b. Payment of prevailing wages;
 - c. Prompt payment to subcontractors (including to design professionals);
 - d. Plans for participation by small, disadvantaged, minority-owned, veteran-owned, women-owned, and underutilized businesses.
7. **Project Review.** Each proposed P3 project must be reviewed by a specialist P3 subcommittee of the Project Review Committee (PRC), evaluating the proposed use of P3. The PRC P3 subcommittee will have expertise in the fields of public policy, private finance, management consulting, engineering, architectural design, construction, construction management, labor, women and minority owned businesses, public-private partnerships, operations and maintenance, and public works law. This PRC Subcommittee issues a recommendation to CPARB, which approves or disapproves the application.
8. **Pilot Period.** In the initial four years, a maximum of four P3 projects per year may be approved, with the objective of approving a balance of project types (e.g. horizontal vs. vertical).

39.10.500 – Definitions

This lengthy section defines various terms used in the legislation. Key definitions include “Public-Private Agreement” and “Public-Private Facility.” The Committee discussed these terms and definitions extensively, ultimately adopting a flexible definition that references specific P3 methodologies (DBFOM, DBOM, DBF) and provides examples of horizontal and vertical facilities, while providing public bodies flexibility in defining and structuring P3 arrangements to provide public benefit.

39.10.510 – Project Planning and Procurement

This section lays out the procurement process for a P3 project. Highlights addressed by the Committee include:

1. **Express enabling language** (.510(a)).
2. **Owner opt-in requirement** (.510(b)). Owners are not required to use the P3 procurement process and are not bound by P3 requirements unless they expressly elect to procure the project as a Public-Private Agreement.
3. **Professional services** (.510(b)). Owners may use traditional Qualifications Based Selection for professional services.
4. **Public interest determination** (.510(c)). The public body must determine P3 is in the best interest of the public. This requires notice and a public hearing, consideration of public comment, and a written final determination, with protest procedures.
5. **RFP or RFQ-RFP Procurement** (.510(d)-(g)). The Committee discussed extensively the details of the procurement process and the appropriate balance between flexibility for owners and defined protections for competitors, project participants, and the public. Many of the RFQ and RFP requirements are adapted from the existing Design-Build statutes in RCW 39.10.
6. **Unsolicited Proposals** (.510(d)). A hot topic in the P3 industry, the Committee recommends allowing private entities to submit unsolicited proposals, but requiring any unsolicited proposal to be subject to the public RFP or RFQ-RFP process. The goal of this approach is to ensure fair competition for potential projects, while avoiding distraction to public owners responding to unsolicited proposals. The Committee recognizes this may provide a disincentive for private entities to submit unsolicited proposals and leave potential value “on the table.” But it also preserves the private sector’s ability to identify innovative opportunities, bring unique financing and funding options to public owners, potentially gaining a marginal advantage over competitors for such innovation. Several other jurisdictions follow this approach.
7. **Evaluation Factors** (.510(g)(i)(4)). While providing flexibility for owners to frame their evaluation process and scoring, the legislation includes a short list of mandatory evaluation factors. Several of the factors draw from and add to the existing design-build statute within RCW 39.10, while others are intended to ensure P3-specific considerations are included.

A freestanding subsection expands upon existing provisions—e.g., in design-build—regarding both labor and disadvantaged business enterprise interests by requiring offerors’ plans for labor harmony and for disadvantaged business enterprise participation to be included as evaluation factors and to be included in the contract (.510(g)(i)(4)(b), .520(c)(9), .570).

8. **Honorarium** (.510(g)(i)(8)). The owner must specify the honorarium terms in the solicitation. This was another point of extensive discussion to achieve an appropriate balance. The legislation requires the owner to delineate whether an honorarium will be paid, including whether the honorarium will be paid if the solicitation is cancelled, and specifies that if an honorarium is to be paid, the honorarium must be sufficient to generate competition and must consider the level of effort required to meet selection criteria, similar to the design-build statute. The honorarium

provision leaves open the possibility that an owner might elect not to provide an honorarium if the circumstances do not warrant one, though it is the Committee's recommendation that owners should generally provide an honorarium except in unusual circumstances.

39.10.520 – Required Contract Terms

While the P3 Committee anticipates P3 projects will likely be implemented by sophisticated public owners who will significantly exceed the basic statutory requirements, the draft legislation includes a short list of fundamental issues that every P3 Agreement must address, as outlined in the Overview above. This section is tailored to provide flexibility for a public owner and private concessionaire to negotiate precisely *how* many of the specified issues will be addressed, while specifically prescribing certain terms such as payment bonds and prevailing wages (.520(c)(9)).

39.10.530 – Reversion to Public Upon Expiration / Termination

Public property involved in a P3 project is to remain public, with all rights, title, and interest reverting to the public body upon expiration or termination of the P3 Agreement.

39.10.540 – Owner Rights Upon Default

This section ensures the owner retains the right, upon material default by the concessionaire and an opportunity to cure, to take over the facility and assume any contracts related to the facility, and to terminate and exercise any other rights and remedies available.

39.10.550 – Public Financing and Funding

The public body may use public financing, including various forms of bonds and notes, to finance all or a portion of a P3 project.

The P3 Committee intentionally did not address the effect of P3 financing on the public body's debt limits, avoiding potential state constitutional issues and preserving issues regarding debt limits, "on-book" vs. "off-book" financing and liabilities, and related issues for analysis under existing law. The P3 Committee recognizes after CPARB, additional work is recommended to be done with the State Treasurer's Office, Joint Transportation Committee, and Governor's Office of Financial Management.

39.10.560 – Additional Funding Sources

The public body may accept and/or enter into agreements with state and federal agencies and private entities for funds through grants, loans, financial assistance, donations, gifts, or property, and may combine funds to finance a P3 facility.

39.10.570 – Labor and DBE

In addition to inclusion in the list of mandatory evaluation factors and contract terms, this section is a freestanding requirement that adequate provision must be made for:

1. Payment of subcontractors, suppliers and laborers, including payment bonds;
2. Prevailing wages;
3. Prompt payment to subcontractors; and
4. A disadvantaged business enterprise participation plan.

39.10.570 – Project Review

A public body must apply to use a P3 method in a process similar to, but more rigorous than, the existing Project Review Committee procedure for D-B and GC/CM. Initial review is by a new PRC Subcommittee with expertise and interest in specified areas relevant to P3 delivery. The application is more involved than D-B or GC/CM, though the legislation recognizes the application will often occur early in the process when the applicant will have only preliminary project parameters and financial data.

The P3 PRC Subcommittee reviews the application and issues a recommendation to CPARB. The application is approved or disapproved by CPARB. CPARB's decision is limited to the proposed alternative public works procurement method only. The Committee's intention is to clarify that the PRC and CPARB are not involved in reviewing the merits of a project or its overall benefit or cost to the public, which evaluation is appropriately addressed through the public body's political and administrative processes.

The legislation includes a four-year pilot period during which a maximum of four P3 projects per year will be approved, ideally including a balance of horizontal and vertical projects. The Committee's intention is to ensure the P3 process is implemented carefully and thoughtfully, with time to implement lessons learned during the rollout period, whether through legislative amendment or an increased focus on best practices among owners and private partners delivering P3 projects.

Additional Owner Considerations for P3

While the P3 Committee's draft legislation would enable public owners flexibility to use P3 approaches to serve the public while protecting key interests of the public and stakeholders, public bodies considering using P3 approaches enabled by the legislation will ultimately need to determine whether a P3 model is appropriate and beneficial for a particular project.

Some projects do not lend themselves well to P3 delivery. As with design/build, GC/CM, or any other delivery approach, the public body must determine whether and how it can use a P3 method to provide value to the project. The public body must similarly determine how to protect and public interest in the arrangement, particularly given the long-term nature of many P3 contract structures.

To provide further context for the Committee's draft enabling legislation, common issues addressed by owners contemplating a P3 approach are summarized below.

Value for Money

As emphasized in the JTC report, a P3 program demands rigorous screening by the public body with analysis tools to determine whether a project is suitable for P3 delivery. As with any significant public project, the public owner's analysis begins with basic programming, feasibility, financial assumptions and pro formas, and evaluation of possible delivery and operational options. The Committee's draft legislation contemplates early financial evaluation by the public owner in considering the suitability of P3.

When considering a possible P3 approach, part of the public owner's initial process often includes a "Value for Money" analysis. In a Value for Money Analysis, the public body compares the projected life cycle cost of possible P3 structures against other more "traditional" options. The Value for Money Analysis generally includes not only estimates of development, design, and construction costs, but also projected costs for operations and maintenance over the full life of the facility, as well as financing costs and any anticipated revenues over time. The Value for Money Analysis typically evaluates the time value of money, analyzing not only how much the project will cost, but when the public body may be required to pay, how the projected costs might differ if the project is implemented at different times, and when the public's payment obligations will be incurred in comparison to any anticipated revenues.

A major consideration in the Value for Money analysis is the possible availability of grants, incentives, and special bonds available for P3 projects. A detailed discussion of the various possible grants, Public Availability Bonds, and other incentives is beyond the scope of this report, except to observe that an owner considering a P3 approach will invariably include the availability of such funding and financing sources in its financial analysis of possible options.

The Value for Money Analysis is just one tool to evaluate whether a P3 approach may be appropriate for a particular project or facility, but it is a useful one that enables a reasoned comparison of the financial impacts of various options.

Design Excellence and Facility Quality

A public body evaluating a potential P3 model must often analyze whether and how it can use the private partner's potential financing and operational responsibilities to incentivize quality design, environmental responsibility, safety, and high long-term performance. In some cases, the public body may be able to

structure the P3 contract so the concessionaire will make more money if the facility runs efficiently and meets environmental and safety targets. The public owner may prioritize design innovation and technical competency in the procurement process. In other cases, the nature of the project itself may incentivize quality design and construction, particularly where the private entity will be required to operate and maintain the facility that it designs and builds. In still other cases, the public owner will need to include extensive and detailed requirements to ensure design and performance parameters are met, with clear consequences for inferior design, low physical quality, or non-performance. Depending on the public owner's objectives, selection of the right P3 model can facilitate meeting these objectives.

As with financial considerations, not all projects are suitable for P3 from a design and quality standpoint. For example, an owner with highly prescriptive design demands, existing specialty operational and maintenance staff, and low O&M costs may find little benefit in a P3 structure, or perhaps a P3 model with less risk transfer. In each case, the public owner must determine whether a P3 model can be used to incentivize or obligate the private party to meet the owner's priorities more effectively than other models.

Risk Allocation

While the financial and technical aspects of a P3 structure must make sense for the approach to be viable, the ability to allocate long-term risk is often a crucial consideration in assessing a P3 model.

One category of risk the owner must often consider involves financial performance. How variable are the initial projections of the facility's costs and revenues? If the project is intended to generate revenue, what happens if the project does not produce the revenue originally projected? What if the facility costs more to operate than expected? If the facility's financial performance is relatively predictable and adequate public financing is available, there will be less value to the owner in transferring risk to the private partner. If there is greater uncertainty regarding costs and revenues, and the private partner may be able to optimize the facility's financial performance, then there may be value to be realized by shifting financial risk from the public to the private sector participants. The P3 contract may be structured to allocate this risk in the manner that best meets the owner's objectives. That could mean the owner retains all financial/revenue risk and simply pays the private entity to keep the facility running and without deferred maintenance, while meeting specified performance criteria (as in the availability model described above). It could alternatively mean the owner shifts all financial risk to the private sector, essentially enabling the private entity to develop and operate the facility to maximize revenue, within bounds prescribed by the owner (e.g. prescribed or maximum rates, usage metrics, efficiency rates, availability standards, safety requirements, etc.)

Another category of risk that might be shifted in a P3 structure involves performance and operational risks. Is there value in having a single entity responsible for the development and operation of the facility? In other words, can a better facility be delivered for the public if the private entity must develop the facility knowing that it must operate the facility for many years? Is there value to the public body in transferring the risk of the facility's underperformance or non-performance to the private developer? What benefits can the public body derive from a structure in which its payment obligation is tied to successful long-term performance? If long-term operational performance is a priority, a P3 arrangement may create value for the public owner. If design and construction parameters are well known and long-term operation and maintenance costs are adequately controllable through traditional contracting methods, a P3 approach may not be beneficial.

Performance Security

A significant consideration in any P3 project is the security package. How will the private concessionaire's performance be secured, not only during the design and construction phase, but over the often decades-long operational life of the facility.

In a DBFOM structure where the private entity is accountable to lenders and investors, and the private entity's compensation is contractually tied to its performance, the lenders and investors have a substantial independent interest in ensuring performance of the contract, since they will not recover their investment if it does not perform. At the same time, the public owner receives a significant degree of security in the fact that it will not be required to pay if the project does not perform. In such cases, the owner might obtain adequate security through the contract structure or by requiring the owner to be a beneficiary of the lender's required security instruments.

At the other end of the spectrum, such as a DBOM model where lenders and investors are not exerting separate performance pressure on the developer, the public owner might require a greater degree of security. The owner might require separate security for various phases of the contract, from design to construction, and then through the O&M period. Is it important for the public to owner to transfer the "interface risk" between the design and construction entity and the O&M provider. Who is accountable if there are performance issues related to design and construction? Again, selection of the right P3 model based on the public owner's needs will impact the value for money.

Public Staffing and Resources

For many major projects where P3 is a viable possibility, the public body must consider whether it has or can assemble the necessary in-house team to deliver and operate the project, or whether it would be more efficient and cost-effective for the project to be delivered and operated through the private sector. In evaluating a potential P3 structure, the owner must additionally consider the extent to which it would need to regulate and oversee the private entity's activities, particularly in comparison to the level of effort and cost if the public body operated the facility directly in the long-term.