The facts of (financing) life: **Why construction owners are pivoting to P3s for major projects**

By Kim Slowey | May 26, 2016

Construction DIVE

hether it's a $2.3 billion overhaul of a piece of Florida highway or a new $513 million civic center in California, a construction project can be extremely expensive. Typically, neither private nor public owners are able to cough up that much cash for the relatively short duration of a construction project. Even if they do have the funds available, they often don't want to tie it up with just one project.

Traditionally, public entities will fund their large infrastructure projects with revenue bonds — municipal bonds issued to finance a particular project and then repaid with the revenue the completed project generates, according to William Eliopoulos, a partner with Rutan & Tucker LLP in California.

State or federal funding — or maybe a mix of the two if Congress decides to fund a state project — is also a standard vehicle. The owners or developers of private construction projects, however, are on their own when it comes to financing, so they'll almost always take out a construction loan to fund a sizeable project if they don't take on equity partners to help fund the deal and to share in the eventual profits.

These are all common, straightforward ways to move forward on either a one-off project or multiple endeavors without dipping into cash reserves. And while public and private funding methods have typically occupied their own sides of the construction financing realm, the two sectors are starting to develop new financing solutions in the middle ground of public-private partnerships (P3s).

An example of P3 financing

A P3 relationship typically involves a public entity, be it a state agency or a local municipality, deciding to undertake a significant public works project like a toll bridge. The entity either doesn't have the money to fund the project up front, or it possibly has an upcoming program of several projects planned and doesn't want to use all of its cash on one bridge.

Therefore, the entity obtains the legislative approval it needs to enter into a contract with a private company or consortium of companies that will design and construct the bridge and then operate and maintain it for years. The entity kicks in an upfront dollar amount to help with the design and

construction, then makes some milestone payments along the way. In the meantime, the consortium is funding the lion's share of the project. When the construction of the bridge is complete, the consortium then starts the decades-long operations and maintenance portion of the contract.

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Up until this point, the consortium has yet to realize any profit from the deal. But now that the toll bridge is operational, that's where the payoff begins. As specified in the contract, the entity begins making payments to the consortium for bridge operations and upkeep, and the consortium gets to take home all or a portion of tolls collected on the bridge for the term of its contract.

While financing details for P3s can be complex, Eliopoulos said, both the public and private sides can still use the traditional methods of bond issues, construction loans or equity financing to meet their financial responsibilities on the project.

Alternative financing options on the rise

The P3 model has taken off and become more widely utilized over the last several years. "My work has picked up tremendously, and there are P3 conferences that draw 1,000 people," said Lee Weintraub, shareholder at Becker & Poliakoff and chair of the firm's P3 group. When executed correctly, the P3 is typically a win-win for both the public and private sides, he said. While the example of the toll bridge might be one possible arrangement, Weintraub said one of his favorite adages about P3s is, "once you've seen one P3, you've seen one P3."

For example, in the aforementioned bridge scenario, although the consortium would benefit from higher-than-expected traffic over the bridge, it also assumes the risk of lower-than-anticipated traffic. Weintraub said this

risk transfer is one of the reasons P3s are so popular. However, in Florida, a Skanska USA-led joint venture is upgrading 21 miles of Interstate 4, but the Florida Department of Transportation decided to assume the risk of usership volume and will simply make scheduled payments to the joint venture during the operations and maintenance period, Weintraub said. This is just one instance of how varied a P3 deal be.

In addition to that risk transfer element, the ability to leverage cash into more projects or simply reduce cash outlays in the midst of a tight budgetary cycle is a P3 benefit for the public entity. Eliopoulos said his firm represents one of the design-build partners on the Long Beach Civic Center project. Because the consortium is shouldering most of the financing burden — and due to the fact that the new buildings will require less maintenance and incorporate cost-saving features — Long Beach's regular payments to the consortium are comparable to what the city is already paying to maintain the existing outdated facility.

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Opportunities and obstacles to broader use

Eliopoulos said he thinks that when public entities need to "spread their funding out," as in the case of Long Beach, P3s will become increasingly popular. "For larger public projects, there's an interest in P3s among the public agencies," he said. However, Eliopoulos added that public entities need to learn how to execute (P3s) ... and in some cases, they need special enabling legislation and increased cooperation with the government to bring down P3 financing costs.

Weintraub said yet another example of a potential financing setup for a P3 is a model with a nonprofit angle that universities have been using to tackle

large projects. “A nonprofit will own the property. They’ll borrow the money that’s needed to do the job, but then they can save money on property taxes because they’re a nonprofit,” he said. “That model is done in a lot of higher education (projects) all around the country.”

According to both legal experts, perhaps the largest obstacle to more public agencies realizing the savings possible with P3s is education about the process and its potential advantages over traditional methods of financing.

“The bigger issue is that public entities need to realize that even though they’d be paying a little bit more in financing costs, getting a developer in there and the efficiencies of doing that over the 35-to-45-year useful life of these new facilities will save them so much more money,” Eliopoulos said.