

The Need for P3

PUBLIC-PRIVATE PARTNERSHIPS CAN HELP BRIDGE AMERICA'S INFRASTRUCTURE GAP.

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PUBLIC FUNDING FOR MAJOR INFRASTRUCTURE projects in the United States is at its leanest levels in decades. At the same time, the need for improvements to public infrastructure is tremendous—a 2009 study from the American Society of Civil Engineers (ASCE) estimates the necessary five-year infrastructure investment at \$2.2 trillion.

The last two decades also have seen increased acceptance of the design-build delivery model and a general recognition that it can increase project delivery efficiencies greatly over the traditional design-bid-build model. The public-private partnership (P3) delivery model combines design-build's delivery efficiencies—extended over a lengthy operations and maintenance period of the public asset—with capital provided by private markets to finance the project. P3 represents an evolution of design-build for major infrastructure projects. This confluence of need and benefit has increased both public- and private-sector interest in P3; the federal government and more than half of the states have now enacted legislation encouraging private firms to invest in public projects.

WHAT IS P3?

P3 is an alternative construction project delivery method that can take various forms on projects of all sizes. Typically, a P3 project involves a long-term partnership between a public entity and a private developer (“concessionaire”), for the concessionaire’s design, build, financing, operation and maintenance of a substantial public-improvement initiative. Usually, though not always, a P3 project is built on public land and involves the construction and operation of public infrastructure with a projected revenue stream that ultimately secures and repays the project costs over time. P3 projects have been successfully completed worldwide in traditional public infrastructure areas such as transportation, transit and utilities including water treatment, and social infrastructure areas including healthcare, judiciary, corrections and education. P3 is not a solution for all public infrastructure needs,

but it is a growing and important tool for public agencies and private entities to consider for appropriate projects.

THE ORIGINS OF P3

The P3 project movement was born of economic necessity, beginning in Great Britain in the early 1990s and spreading to Australia, Canada and Europe. These governments—strapped for funding and desperate for transportation and healthcare infrastructure—embraced P3 as an important method for providing critical services to the public. They adopted broad, systematic government programs to spur the development of the P3 delivery method. More than 1,400 P3 contracts have been signed in the European Union over the last 20 years, representing an estimated capital value of approximately \$340 billion.

P3'S FINANCIAL ADVANTAGE

A traditional public-works megaproject typically involves some form of public bond financing, often supplemented by federal grant money, to raise the funding necessary to pay the design and construction costs over several years during the project’s design and construction phase. In a P3 project, a private concessionaire typically obtains all or most of the financing instead, and is paid by the public owner via milestone and other “availability” payments once the improvement is substantially complete and placed in service.

The private concessionaire typically employs a hybrid of various project finance tools on large P3 projects, including (1) private equity investment by the concessionaire and/or investors; (2) private loans from commercial lenders; (3) government grants; (4) federal government loan and guarantee assistance programs such as TIFIA and SAFETEA-LU; and (5) corporate bond financing such as private activity bonds, which are issued on behalf of a private entity and generally restricted for use on projects that benefit the public.

By using private financing or a hybrid of private and public financing on P3 projects, public agencies can leverage their infrastructure construction budgets over longer time periods and cover more projects.

P3 AND RISK

P3 projects manage responsibility and risk more efficiently. P3 project design is typically performance-based rather than prescriptive, giving the concessionaire the freedom to maximize efficiencies and take advantage of its expertise in design and construction.

A P3 project typically places the traditional duties for construction of the project on the concessionaire, including greater responsibility and risk for items such as systems testing and inspection, obtaining government permits and approvals, testing and removal of hazardous materials, differing site conditions, indemnities, insurance and extended warranties.

In payment responsibility and risk, P3 projects typically involve availability payment schemes. An availability payment concession keeps the payment responsibility with the public owner, but often seeks to delay substantial payments to the concessionaire until the construction is complete enough to be placed in use and provide revenue to the public owner.

In either case, a substantial portion of the payment for construction is made to the concessionaire after the facility is substantially complete and begins generating revenue. This can allow public owners to leverage infrastructure construction budgets and spread financing over longer terms and multiple projects, but the concessionaire typically carries substantial risk and burden. P3 projects also

often involve a form of performance guarantee with monetary incentives or penalties tied to asset availability and performance after completion.

P3 AND PUBLIC WORKS

P3 projects are an appropriate choice for many kinds of public works infrastructure projects. Typical P3 projects include traditional infrastructure such as utilities, transportation and transit projects that generate toll revenues, and social infrastructure projects in healthcare, education and justice systems. The driving force behind its increasing consideration by public agencies? P3 can deliver better value for the money by focusing on the core competencies of private sector enterprise focusing asset development goals on long-term “life cycle” costs including extended operations and maintenance life, and allocating risk to the party best able to manage it.

While the P3 delivery method includes greater and more extended risk for the concessionaire and contractor, if the contract terms and price reflect the risks fairly, P3 can offer them large projects, more control, fewer competitors and often a best-value, qualitative element to the bid selection process. 

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