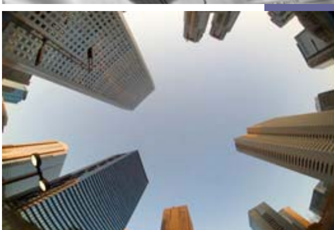
California Debt & Investment Advisory Commission



Questions For Public Agencies Considering Public-Private Partnerships

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Commission Overview

The California Debt and Investment Advisory Commission (CDIAC) provides information, education and technical assistance on debt issuance and public fund investments to local public agencies and other public finance professionals. The Commission was created to serve as the State's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt. Its mission was later expanded to cover public investments.

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INTRODUCTION

With increasing frequency, local governments across California seek alternative ways to pay for structures such as roads, sewers and buildings. They look beyond traditional public debt mechanisms (including bonds and dedicated tax-revenue streams), to consider using private, taxable financing. Governor Schwarzenegger's office dubbed these mechanisms "performance based investments" (PBIs), while investment bankers often refer to them as Public Private Partnerships (P3s). California's local governments are not typically familiar with these alternative mechanisms and may seek guidance in weighing their financing options.

This guide is intended to help local officials evaluate the conditions and structures under which a P3 is the best choice. Presented in a question-and-answer format, it answers questions that the governing board members may be asking. For example, the guide asks questions about:

- Issues related to an agency's statutory discretion to enter into a partnership,
- Project characteristics that enhance the likelihood of success with a public-private financing, and
- Public policy judgments the governing board should consider before approving a P3.

CDIAC provides additional analysis on the potential use of P3s by public agencies in the following publications: *Privatization vs. Public-Private Partnerships: A Comparative Analysis* and *Public-Private Partnerships: A Guide to Selecting a Private Partner*.

Questions and Answers

What are the public agency's goals?

A P3 can serve many public finance purposes. To match the particular P3 mechanism to this purpose, the public agency should clearly identify its project's goals. These may include the potential to realize cost savings, utilize outside expertise not ordinarily available to the public sector, achieve efficiencies in construction and operation, access private capital, create new sources of revenue and improve the quality of services through a partnership. The right P3 mechanism can enable an agency to attain its project's goals.

What are the public agency's financing options?

Developing a financing plan that identifies all financing options is an essential step for making the case for a P3. Typical public agency financing sources include taxes, special assessments, bond financing (e.g., general obligation bonds, revenue bonds), pay-as-you-go funding or state and federal grant funds. P3s are another financing option available to public agencies. A financial advisor can be retained early in the project development process to assist a public agency with determining which financing options would best enable the agency to achieve its project goals in the most cost effective manner.

What types of projects are suitable for a P3?

In the United States P3s have been used for project delivery in the transportation, water, wastewater, schools, prisons and defense infrastructure sectors. Since each sector is different, P3 policies, approaches and political strategies must be tailored to the unique circumstances of each sector and project.

Based on a review of public agencies' previous successes with P3s, projects that exhibit the following characteristics may be well-suited for a partnership:

- The project will result in cost savings (construction and/or operational costs) from private sector involvement with the project.
- The project presents an identifiable commercial opportunity, where the cost of the service or project can be recovered through user fees.
- The project cannot be provided with existing public resources or expertise.
- The project or service provides an opportunity for innovation.
- The project is not a core government function and is receptive to private involvement.

Is the project financially feasible as a P3?

As well as being practically suited for a P3, a project must also be financially feasible. A private partner may provide the initial funding for capital improvements, but there must also be a form of repayment for this investment realized over the long-term partnership. The revenue stream can be generated by a variety and combination of sources (fees, tolls, shadow tolls, tax increment financing, or a wide range of additional options), but should be assured for the length of the partnership.[1]

What risks does the public agency retain in a P3?

In a P3, risk is not limited to just liability but includes the assumption of responsibility for conceptual, operational and financial uncertainties that could threaten the goals of the partnership. These risks include design and construction costs, regulatory compliance environmental clearance, performance, and customer satisfaction. Risk is shared based on the principle that risk should be assigned to the partner that

[1] The National Council for Public-Private Partnerships, "Keys to Successful Public-Private Partnerships," www.ncppp.org (Last visited, July 15, 2008).

is better equipped to manage or prevent that risk from occurring or that is in a better position to recover the costs associated with the risk. A public agency can expect to retain the risk associated with securing all levels of government review and approvals, environmental permitting, right-of-way acquisitions, as well as, any resulting change orders required of the private partner (including associated cost increases). For capital improvement projects, the private partner may assume risks of a commercial nature that can be appraised and controlled such as construction cost overruns, leaving the residual risks to the public agency.

Does the public agency have a P3 policy objective?

A public agency should develop a P3 policy that encompasses objectives that are suited to the best interests of the public agency and its constituents. It is essential that all policy makers, agency officials and stakeholders agree on the goals of a P3.

Public policy that supports the use of P3s should enable a public agency to utilize procurement practices that will achieve the best value for the delivery of public service or provision of public infrastructure. Public policy considerations concerning P3s could encompass guidelines, protocols and an acceptable process to be followed for implementing a P3 as well as handling their acceptance with the general public. As an example, public policy objectives for a public agency could include the following:

- To deliver quality government services in the most economical, effective and efficient manner.
- To utilize the full potential of public sector assets for the benefit of the public.
- To ensure the best interests of the public and the private sector are served through the appropriate allocation of risks and returns between the partners.

How does the public agency identify and involve stakeholders?

Early and continuous involvement and communication with stakeholders is one of the National Council for Public-Private Partnerships keys to a successful partnership.

Identifying and involving stakeholders early in the development of a P3 is crucial to its success. Stakeholders can encompass a large group of people outside of the two immediate partners. This group can be made up of public agency employees, employee unions, other agency staff, other levels of governments, other agencies involved in the provision of the service, end users of the service, specific user groups, as well as the general public.

Once the stakeholders have been identified, a public agency needs to establish an open line of communication to address concerns and minimize potential resistance to the partnership. To foster communication, a public agency can hold public meetings, use TV/radio/newspaper advertisements, host an internet website focused on the P3, dedicate phone line for up-to-date information on the P3 and hold public meetings. To get stakeholder input and feedback on the P3, a public agency may wish to take public comments at public meetings, conduct surveys (by mail/telephone/internet), or conduct public workshops.

Does the public agency have the legal authority to pursue a P3?

As an alternative procurement method, P3s use variations of traditional government procurement strategies that may not be authorized under a public agency's existing legislative authority. P3 project models vary, as each public agency has its own specific need for considering a partnership, ranging from contracting for operations and maintenance of a public facility to the design, construction, financing and operation of a public facility; therefore, a public agency should engage its legal counsel to ensure it has authority to enter into a P3. This includes review of all applicable statutes, local, state and federal, to ensure compatibility for this procurement method. When performing a legislative review, the public agency should identify any limitations or parameters of the enabling statute that may impede the type of P3 being considered.

In addition, procurement statutes vary greatly between public agencies. Because public agencies need the flexibility to select a procurement process that is most appropriate for a particular project, they should ensure statute and policy provide the agency with the authority to achieve their goals. The chart below outlines the optimum features of legislation authorizing the use of P3s:

Features of Legislative Framework Conducive to P3s
- Gives public entities considerable flexibility in the types of agreements they may enter into and in the specific procurement process. - Allows contracts to be awarded according to best value, not just lowest price.
- Allows mix of public and private dollars.
- Allows "mixed concessions" (such as, reconstruction or expansion, plus the long-term operation of existing facilities).
- Allows long-term leases of existing government assets. - Authorizes procedures to receive and consider unsolicited proposals.
- Avoids provisions that would require further legislation to authorize or finance a project, execute a franchise agreement or change toll rates.

Source: Nossaman LLP

Should outside advisors be retained?

Prior to endorsing the use of P3 for a project, a public agency will require the experience and guidance of professionals that have a wide range of expertise. Some of the most basic skills a public agency requires for administering a P3 are contract law, contract management, project management, performance auditing and quality control, financial analysis, marketing and communications, and risk management. For a public agency without experience with a P3, an advisor with overall expertise in P3s could be retained. The more specialized a project or P3 becomes, the more likely that an outside expert needs to be retained.[2]

Assembling a team of experts for a P3 would be similar to assembling a financing team for a bond issuance; if expertise in not available in-house, then outside expertise should be hired. The team can provide experience where needed whether acting as the expert or augmenting agency staff.

What types of analyses should be conducted prior to any decision to pursue a P3?

To determine if a public-private partnership will work, most communities first assess the potential benefits that could result from such a partnership. Such a feasibility study examines the existing condition and cost of facilities and any needs to meet mandated compliance schedules. Potential benefits to continued public services, or more efficient provision of public services, are compared to options and benefits to services being provided privately. Such a comparison most often includes looking at what other communities have done in similar circumstances to gain additional perspective on what might be accomplished in the public agency's community. If the potential benefits of private service are sufficiently attractive, the next step is to go to the marketplace for competitive proposals.

[2] "Public Private Partnership: A Guide for Local Government," Ministry of Municipal Affairs, British Columbia, (May 1999, British Columbia) p. 33.

How does the public agency ensure that it retains control over the project?

P3s enable a public agency to utilize the resources of the private sector while maintaining a high level of public control of a public project. A public agency enters into a contract with a private partner in order to fulfill its own objectives, policies and goals. These agency driven outcomes serve as the basis for the contract that creates the P3. The legally enforceable contract outlines the roles, responsibilities and expectations of each partner, usually providing incentives for delivering projects on time and on budget. To ensure a high level of accountability and control over the project, the public agency should ensure the contract contains the following elements:[3]

- Designate responsibility for future expansions, repairs and maintenance.
- Determine how the scope and timing of those projects will be decided.
- Establish performance standards.
- Outline conditions for future contract amendments.
- Address failures to comply with the contract.
- Limit revenue charges (i.e. address rate of toll increases).
- Provide early termination provision for the agreement.

Outside of its contract delineated responsibilities, a public agency should monitor the project to ensure performance standards are being met for the duration of the contract.

[3] Gilroy, Leonard C.; Robert W. Poole, Jr.; Peter Samuel, and Geoffrey Segal, "Building New Roads through Public-Private Partnerships," Reason Foundation (March 2007). p. 4.

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