

A GUIDE TO UNDERSTANDING AND EVALUATING

Infrastructure Public-Private Partnerships

JANUARY 2017

A PUBLICATION BY

ITPI | IN THE PUBLIC INTEREST

America's infrastructure needs an overhaul. In 2013, the American Society of Civil Engineers' (ASCE) report card on the nation's infrastructure gave the U.S. a grade of "D+." The embarrassing grade was based on unmet needs to repair and rebuild roads, bridges, drinking water and wastewater systems, schools, rail and transit systems, and public parks.¹ ASCE also estimated that the country needed to spend \$3.6 trillion in the succeeding seven years to recover from decades of neglect and disinvestment.²

Many local and state governments are looking at new financing arrangements—public-private partnerships (known as "P3s") that use private capital to finance public projects—to help fill the gap. But inserting private interests into the development of public infrastructure has proven to be difficult and even counterproductive when equity considerations and standards aren't included and adequate care isn't taken to protect the public interest.

Public funding of infrastructure is well known to be the least expensive way to finance major infrastructure projects. But in light of financial and political obstacles that governments face, some policymakers are pursuing private financing for public assets. If a government is going to consider a public-private partnership, we believe it is critical to ensure that the arrangement is truly structured as a win-win-win proposition that retains public control over our shared public assets:

- ▶ A win for the public because infrastructure has been rebuilt
- ▶ A win for the economy by creating jobs that lift families out of poverty, preserving a thriving middle class, and building infrastructure essential for efficient development, production, and distribution of goods and services
- ▶ And a win that generates an adequate rate of return for double-bottom line investors

Unfortunately, many proposed P3 projects are not structured as win-win-win propositions. This guide aims to help advocates, policymakers, and other stakeholders better understand and analyze infrastructure project proposals, contracts, and related legislation. We describe critical issues and include a list of key questions stakeholders can raise to ensure that a given project advances the public good. While this is not an exhaustive list of questions, it provides a useful framework to examine P3 deals.

ITPI | **IN THE PUBLIC INTEREST**

In the Public Interest is a non profit research and policy center committed to the democratic control of public goods and services. We help citizens, public officials, advocacy groups, and researchers better understand the impacts of government contracts and public-private agreements on service quality, democratic decision-making, and public budgets. For more information, please visit www.inthepublicinterest.org.

¹ American Society of Civil Engineers, 2013 Report Card for America's Infrastructure, 2013. <http://www.infrastructurereportcard.org/>

² Ibid.

WHAT ARE PUBLIC-PRIVATE PARTNERSHIPS (P3s)?

In the building of new infrastructure or the repair of old infrastructure, there are typically five important activities:

- ▶ Design of the project
- ▶ Construction (referred to as “Build”)
- ▶ Financing of the project
- ▶ Operation of the asset
- ▶ Maintenance of the asset

Traditionally, infrastructure projects are built with public debt raised through tax-exempt bonds sold to individual investors and institutional investors like pension funds and mutual funds. The debt is paid back by individuals and businesses through either taxes or user fees, such as fares or tolls. Engineers and architects design the project (some public and some private), construction companies (always private) build it, public agencies run it and maintain it, and public finance offices manage the money by paying off the debt over the life of the asset. Traditional procurement for infrastructure is typically referred to as design bid build (DBB), where the governmental entity does everything except for the construction work; or design build (DB), where a private entity designs and builds the asset, but the governmental entity finances it, operates it, and provides maintenance services.

The term “public-private partnership” has become an imprecise catch-all that can capture the traditional procurement described above, but is now typically used to describe a project that privatizes all five activities in the process. In the *Key Questions to Ask* section below, we will use the term “full P3” to refer to a project where a private entity designs, build, finances, operates, and maintains an asset. This is also referred to as a DBFOM. Note that there are other variations between traditional procurement and a full privatization P3, such as a design build finance (DBF) and others.

Additionally, existing assets can also be privatized via contracts like the following:



Long-term lease agreement: This is an agreement in which a private entity (or entities) receives the right to collect revenues associated with an existing asset in exchange for an upfront fee to the governmental entity. Examples of this model include the long-term leases of the Chicago parking meters mentioned below and the Indiana Toll Road.³ This type of arrangement is also commonly referred to as a P3.



Sale-Leaseback: A “sale-leaseback” is a transaction in which the owner, in this case the government, sells public property and then leases it back from the private buyer. Examples of this model include the sale-leaseback of Arizona’s capitol and state buildings.

Specific questions in the *Key Questions to Ask* section address special circumstances regarding the proposed privatization of existing assets.

³ Angie Schmitt and Payton Chung, “The Indiana Toll Road and the Dark Side of Privately Financed Highways,” Streetsblog USA, November 18, 2014. <http://usa.streetsblog.org/2014/11/18/the-indiana-toll-road-and-the-dark-side-of-privately-financed-highways/>

WHAT ISSUES DO PUBLIC-PRIVATE PARTNERSHIPS RAISE?

While P3s have received much attention as a way to combat our country's infrastructure woes, they are no panacea. A closer examination raises issues that warrant careful consideration for decision makers looking to undertake a P3.



LOSS OF DEMOCRATIC CONTROL OVER PUBLIC POLICY AND DECISIONS

Many P3 contracts include non-compete clauses and/or compensation clauses, which limit or eliminate the public's long-term ability to make critical decisions necessary to improve our cities and transportation systems and to address climate change.⁴ For example, in 2008, the city of Chicago signed a 75-year contract with a global consortium led by Morgan Stanley to run the city's 36,000 parking meters. Mayor Richard Daley proposed the plan and rushed city council approval four days later with no opportunity to carefully examine the proposed contract or solicit public input. The council vote was reduced, in the depths of the Great Recession, to a choice between massive public layoffs or an immediate \$1.1 billion infusion of cash. The contract includes compensation clauses that require the city to pay the global consortium for lost revenue resulting from standard policy and planning decisions, such as the creation of new bike lanes or bus rapid transit lanes or temporary uses such as street fairs, for the life of the 75-year contract.



PROFITABLE PROJECTS DRIVE PUBLIC DECISIONS ABOUT WHAT GETS BUILT

Private investors naturally demand rates of returns that need a profitable revenue stream—projects that generate high tolls, water rates, or transit fares. Additionally, many financing schemes also require the government to pay guaranteed annual payments, referred to as “availability payments.” Simply put, the private sector cannot be relied upon to provide investment for the many critical infrastructure needs that are not profitable, such as smaller projects, repair projects, or projects in rural areas. For example, aging lead pipes in need of replacement are much more common in the lowest-income cities.⁵ Replacement and repair projects, which comprise the vast majority of the country's critical infrastructure projects,⁶ don't attract private investors. But neglecting these projects can have profound negative consequences, as evidenced in the recent water crisis in Flint, Michigan. Moreover, P3s can lock public funds into profitable projects, rather than needed projects, meaning that a shift towards P3s in Michigan could reduce the availability of public funds that could be used to repair water pipes in Flint.

⁴ Donald Cohen and Stephanie Farmer, “Why Chicago's Botched Parking Meter Privatization Is Also Bad for the Environment,” *Next City*, June 4, 2014. <https://nextcity.org/daily/entry/infrastructure-projects-p3-contracts-chicago-parking>

⁵ Elizabeth McNichol, “It's Time for States to Invest in Infrastructure,” *Center for Budget and Policy Priorities*, February 23, 2016. <http://www.cbpp.org/research/state-budget-and-tax/its-time-for-states-to-invest-in-infrastructure>

⁶ Kevin DeGood, “How Donald Trump's Infrastructure Plan Fails America,” *Center for American Progress*, December 1, 2016. <https://www.americanprogress.org/issues/economy/reports/2016/12/01/293948/how-donald-trumps-infrastructure-plan-fails-america/>



REDUCED LABOR STANDARDS

Promised cost savings often derive, at least in part, from reduced wages and benefits for construction workers who build infrastructure and workers who operate and maintain public assets. In a full privatization P3, permanent operations and maintenance workers are private sector workers with lower wages and reduced health and pension benefits.



LIMITED ACCESS AND AFFORDABILITY FROM INCREASED SHIFT TO FEE-BASED INFRASTRUCTURE

Private investment often brings a heavier reliance on tolls and user fees to pay for infrastructure, as well as the private entity's return on their investment. This makes progressive affordability schemes more difficult to create. In practice, privatized projects have resulted in much higher costs for residents, becoming increasingly unaffordable for lower income people and thus reducing equitable access to critical infrastructure.



PUBLIC INFORMATION BECOMES CONFIDENTIAL AND PROPRIETARY

Publicly financed and operated infrastructure projects are transparent and subject to applicable sunshine laws. Financial documents, planning documents, usage projections, wages, construction contracts, and performance reports are public documents. The rules are different for privatized projects where much of this information is deemed private. In Texas, the private consortium tapped to develop State Highway 130 between San Antonio and Austin filed for bankruptcy when revenue projections failed to materialize.⁷ In response to an open records request, the consortium, led by Spanish infrastructure developer Cintra, refused to release the traffic projections on which the project was based. They claimed the projections were proprietary information that, if public, could help their competitors. The Texas Attorney General and the Federal Department of Transportation agreed.



⁷ Katherine Blunt, "The end of the road," San Antonio Express-News, September 16, 2016. <http://projects.expressnews.com/the-end-of-the-road-texas-130-toll-road>

KEY QUESTIONS TO ASK

Below is a list of questions that identify key issues in proposed asset privatization deals. As mentioned above, this is not a complete and exhaustive list, but the questions provide a framework for evaluating infrastructure P3s.



IS THERE A THOROUGH UNDERSTANDING OF THE ASSET?

- ▶ What is the “public purpose” of the existing or proposed asset?
- ▶ How does or will the community use the asset? Who are the stakeholders?
- ▶ How does or will the asset meet community needs?
- ▶ Are there existing laws, such as state P3 enabling laws, that apply to the asset or proposed infrastructure project?



HOW IS THE PROJECT SELECTED?

- ▶ What infrastructure is needed in the locality or region to best meet the needs of the community? What infrastructure projects are currently prioritized in government planning documents?
- ▶ Is the proposed infrastructure a priority project for the locality or region? Is the proposed project consistent with local and regional planning goals, or has a private entity submitted an unsolicited bid for its creation?
- ▶ If the project proposal is unsolicited or not part of the region's infrastructure plan, will the creation of the asset take away financial and political opportunities to build or repair other more critical infrastructure?



HAS THE GOVERNMENTAL ENTITY EXAMINED ALL OPTIONS?

- ▶ What are the various procurement methods being considered for the project and why?
- ▶ Has the governmental entity performed or contracted for an analysis of various procurement options? In most cases, governmental entities rely on a Value for Money (VfM) analysis to compare lifecycle costs of designing, building, financing, operating, and maintaining an asset when using various procurement methods. A VfM analysis typically compares traditional procurement such as design bid build (DBB) or design build (DB) to a procurement approach with greater private sector involvement, such as a design, build, finance, operate, and maintain (DBFOM or full privatization P3).
- ▶ How does the VfM analysis justify one procurement option over others? Methodology can dramatically alter the results of the VfM analysis. It may be necessary to get

outside expertise to review the VfM analysis, including the assumptions used, identified risk factors, and calculation details.

- ▶ Does the VfM analysis and broader analysis of options consider non-financial public interest criteria including social and economic impacts; affordability and accessibility of the infrastructure to low income communities; the number of high quality jobs the project will create; environmental impacts; and accountability and transparency measures?
- ▶ If the governmental entity must use private equity financing, has it considered the option of using direct public employees for some or all of the maintenance and operation of the asset, instead of outsourcing these functions?
- ▶ If an existing asset is being proposed for privatization, has the governmental entity performed or contracted for a valuation of the asset? If so, how was the valuation determined and what methodology was used? The methodology can dramatically increase or decrease the valuation range. It may be necessary to get outside expertise to review the valuation and methodology, including the assumptions used and the details of the calculations.
- ▶ If an existing asset is being proposed for privatization, has the governmental entity prepared an economic analysis describing potential revenues and expenses if the asset remained in public hands? Has the governmental entity identified alternatives to privatization that include rate or fee increases going directly to the public rather than a private contractor? Alternative options could also include the governmental entity improving its management of the asset, probably with increased fees or rates; shorter leases; revenue sharing; or some combination of these alternatives.



HOW WILL THE ASSET BE FINANCED?

- ▶ Why is private equity financing being considered for the project in lieu of traditional public financing? Has traditional public financing been considered?
- ▶ Are there obstacles in the way public financing?
- ▶ What other funding and financing streams will be used for the proposed project?



WHAT IS THE LONG-TERM IMPACT ON THE GOVERNMENT BUDGET?

- ▶ How will the governmental entity compensate the private entity? Typically, private investors are paid back through the rights to revenue streams associated with the asset (such as tolls or fares) or through regular payments from the governmental entity, known as availability payments.
- ▶ What are the implications of the compensation schemes to the governmental entity's budget?

- ▶ What are the transaction costs that the governmental entity will incur with a P3 approach, such as contracting costs and oversight costs?
- ▶ Will the governmental entity incur hidden costs with a P3 approach? For example, jobs created from a project that pay low wages or fail to provide health insurance benefits may result in an increase to another part of a governmental entity's budget, as the need for social safety net services will increase.
- ▶ An existing asset might provide revenue to the governmental entity, such as a building with a public parking garage, advertising, or cell phone towers. If the asset currently provides net revenue to the budget, how will that revenue be replaced?
- ▶ If a proposed privatization deal for an existing asset requires investors to make a large upfront payment to the governmental entity, are there budget restrictions that prevent the funds from being used too quickly?
- ▶ How will the proposed privatization deal impact the governmental entity's bond rating? Are there risk factors associated with the deal that could impact the governmental entity's future cost of borrowing?



WHAT IS THE IMPACT ON THE WORKFORCE?

- ▶ What will be the potential impacts on the existing and/or future workforce, including both the construction workforce and the long-term operations and maintenance workforce?
- ▶ Are the workers currently unionized and does the Collective Bargaining Agreement or government policy contain clauses that require workforce retention, retraining, or labor peace?
- ▶ How many jobs will be created and what will the wages and benefits be for these jobs? If this is an existing asset, how will the number of jobs and compensation change once control is shifted to the private sector?
- ▶ Who will receive any new jobs? Are there opportunities for a proposed project to include policies, programs, or agreements that ensure that residents in surrounding areas, especially those in nearby low-income urban or other disadvantaged communities, are offered employment and career training opportunities?





WHAT ARE THE COSTS TO THE PUBLIC?

- ▶ If the asset has an associated user fee, what rights does each party have with regard to rate setting and rate increases?
- ▶ What will be the impact on the public of significant or rapid rate increases? Will rate increases affect equity of access to the asset?
- ▶ Will the proposed privatization of this existing asset result in the loss of indirect benefits provided by the asset? For example, a public parking garage may provide support for a nearby retail and restaurant area, but access could diminish once the garage is no longer publicly controlled, hurting local businesses.



IS THERE FULL TRANSPARENCY?

- ▶ What rights does the public have to see documents related to the deal, including the VfM analysis, bid documents, and the contract, especially through online disclosure?
- ▶ Are there adequate and meaningful forums for public input, such as public hearings or public comment periods?
- ▶ Do legislative or other oversight bodies have access to the information they need to evaluate the contract?



ARE THERE POTENTIAL CONFLICTS OF INTEREST?

- ▶ How are contracts with consultants, lawyers, and other third parties structured? Do they collect fees for services rendered or for successful completion of deals, regardless of the outcome for the governmental entity?
- ▶ Do the consultants, lawyers, or other third parties have any conflicts of interest? What is their track record and background with these types of contracts?
- ▶ Have the private contractors, investors, or consultants made campaign contributions to relevant decision makers?





DOES THE GOVERNMENTAL ENTITY HAVE CAPACITY AND EXPERTISE TO NEGOTIATE WITH INVESTORS?

- ▶ Does the governmental entity have the necessary experienced staff to negotiate a good deal for the public?
- ▶ Does the governmental entity hire consultants to assist with parts of the deal? Does the governmental entity have the necessary and experienced staff to ensure that outside analyses are fair and sound?
- ▶ Does the governmental entity have necessary in-house staffing and expertise to adequately monitor the contract for the entire life of the contract?



HOW DO THE TERMS OF THE CONTRACT IMPACT DEMOCRATIC CONTROL OF THE ASSET?

- ▶ How long is the proposed P3 contract?
- ▶ Does the proposed P3 contract contain non-compete clauses? Does a proposed P3 contract contain compensation clauses, or at least limit the scope of its compensation clauses? If so, what are the types of immediate and future public planning and policy decisions that could be limited by these types of contract clauses?
- ▶ Does the contract contain specific operations and maintenance standards, including a hand-back provision that specifies the minimum condition for the infrastructure asset when it is returned to the public at the end of the contract term?
- ▶ Does the contract include performance standards that ensure a high quality asset operates to meet the needs of the community?
- ▶ Does the contract contain include environmental performance standards that specify environmental outcomes that the project must achieve?
- ▶ Does the contract contain robust oversight provisions, including establishing regular reporting requirements and rights of the state to inspect and audit the infrastructure asset?
- ▶ Does the contract include termination and “buy back” clauses, which lay out how the state can take back an infrastructure asset?
- ▶ Does the contract include provisions related to default and bankruptcy of a private contractor to protect the state and the public in case the project or a private entity financially fails?
- ▶ What rights does the governmental entity have to review and restrict refinancing, or sale of interest, by the private entity?
- ▶ Can the asset be securitized, re-packaged, and resold to other investors without the approval of the governmental entity?