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Public-Private Partnerships: A Growing Trend (Part I)

This article is part one of a series of three articles by the author regarding public-private partnerships.

By Edward B. Lozowicki

At an increasing rate, state and local governments are considering public-private partnerships, or "P3s," to finance, design and build public infrastructure projects. A P3 refers to a contractual agreement between a public agency and a private entity, whereby the private entity provides the financing, design, development, construction, operation, and/or maintenance of a public infrastructure project. It could be said that the trend in the U.S. toward P3 financing structures began in 1989, when California enacted Assembly Bill 680, authorizing P3s for several transportation projects and leading to the construction of two toll roads in Southern California. Today more than half the states have P3-enabling legislation, and P3s are being considered for an increasing number of projects. Canada has likewise seen the growth of P3s in recent years, with 27 such projects reaching financial closing between 2004 and 2007. Indeed, Canada now has a federal P3 office, and P3 agencies in Quebec, Alberta, Ontario and British Columbia.

Unlike privatization, in a P3 agreement the public agency typically retains ownership of the project and oversight of its operation, and controls the amount of involvement of the private entity. Some of the benefits of a P3 are that the costs of the investment can be spread over the life of the project, as compared to traditional "pay as you go" financing, and many of the risks of financing, construction and maintenance of the project are transferred to the private sector. There are, however, some areas of concern in a P3 structure that should be borne in mind by the public entity. First, regardless of who is legally responsible for which aspect of the project, because it is a public project the public agency will be held accountable for any of its failings by the general public. Second, public agencies will have to plan for longer-term contract management when entering into these sorts of arrangements. Third, there is a potential for job loss in the public sector in large P3 projects, as private entities assume responsibility for various facets of the project that would traditionally be carried out by the public sector.

P3 projects may be procured through a variety of contractual structures. One of the more

common P3 procurement types is a concession agreement, in which a private entity finances, designs, builds and operates the project under a long-term license from the public agency. Title remains with the public agency through completion of construction, but the private entity takes possession and continues to operate the project for the period of the license. Another common type of procurement is lease-leaseback, in which a private entity enters into a ground lease from the public agency, designs and builds a project, then leases it back to the public agency until the lease is fully paid, at which time the lease terminates. Here the agency remains in possession of the project and retains title to the project. In the former case, the concessionaire collects revenue from the operation of the asset and uses it to pay the cost of finance, design and construction. In the latter, the public agency is paying rent to the developer, who uses it to pay back the costs of the project. In both scenarios, however, the public agency retains title. This is a fundamental difference between P3 and privatization, since in the latter, title transfers to the developer up front. Several permutations of the procurement structures described above are also possible. For more information and for case studies of various P3s planned and in use throughout the U.S., see The National Council for Public-Private Partnerships, How Partnerships Work (April 27, 2007).

Statutory recognition of P3s

To date, P3 structures for the financing of public infrastructure projects are authorized by statute in at least sixteen states, and the use of P3s is under evaluation in several others. These statutes are predominately found under code provisions for transportation projects. One reason this type of project has been so well-suited to the P3 structure is that the public is used to and generally accepts transportation fees, such as those imposed by rail tickets and toll roads and bridges. Private financing of these projects is thus easier than other types of public projects because the direct fees of the project users can offset the cost of service.

P3s have also been utilized for other public purposes, including water, wastewater, schools, and prisons, to name a few. In California, P3s are now authorized for use by local public agencies in such diverse fee-producing construction projects as energy or power production, water supply, treatment and distribution, commuter and light rail, highways and bridges, and buildings not used primarily for sports or entertainment events. (However, the enabling statute for these projects expressly excludes state agencies from its provisions.) The Natomas school district in Sacramento, for example, employed a P3 financing structure to build a new high school, using a lease-leaseback model to lease part of its land to a private developer, who financed and built the school. Another example of a successful P3project in California is the Alameda Corridor Rail Project, in which a collection of bridge, rail and street improvements were accomplished along a 20-mile stretch of railway in southern California using a P3 financing structure between a joint powers agency and the user-railroads which paid fees to finance design and construction.

In parts two and three of this series, we will address how P3 structures may conflict with other public works laws.

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