UNDERSTANDING THE 4 "Ps" BEFORE THE P3 (PUBLIC-PRIVATE PARTNERSHIP)

By Seth Merewitz, Partner, Best Best & Krieger, LLP,
Chair of the Public-Private Partnership/Joint Venture Group

When Edmund G. "Pat" Brown, Sr. was the governor of California (1959 to 1967), major infrastructure projects were being constructed throughout the state. Today, under Governor Jerry Brown, communities are struggling to fund needed capital expenditures and required upgrades from new state and federal regulations.

New infrastructure investment is falling further and further behind the needs of our local communities. Aging and inadequate infrastructure, required upgrades and scarce public financial resources to pay for construction of new facilities is fostering a new spirit of innovation — out of necessity, rather than desire. We can do better!

Public-private partnership (P3) is a tool that is being considered and implemented in California and elsewhere for economic development, real estate asset monetization and regional- and local-serving infrastructure. The P3 term can refer to any or all of the following: procurement, project delivery (including design, construction, operation, maintenance or any portion of project delivery), a method of financing or mechanism for risk transfer.

P3 is not only a financing mechanism! In a successful P3, the public agency and the private investor function as "partners" pursuant to a contractual relationship throughout project development, financing, construction and even operation and maintenance.

The National Council for Public-Private Partnerships defines a "public-private partnership" as a "contractual arrangement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility."

To meet the local and regional needs of our communities, there is renewed interest in P3, but this is not a new mechanism. In 1652, the Water Works Company of Boston was the first private firm in America created to meet a public need by providing drinking water to the community. However, the American experience took us in a different direction. While in Europe, the vast majority of local serving public infrastructure, water and wastewater is privately-owned and operated, in America and, specifically California, we see most local-serving infrastructure municipally-owned and operated.

To get a P3 proposal to the starting line, public officials need to make sure that there is clarity and agreement on basic issues and priorities.

P3s utilize many different deal structures and financing techniques to deliver projects that each allow for a certain amount of "risk shifting" from the public to the private entity. The public agency can also benefit from the expertise of the private provider, receive a project quicker than the normal procurement methods (for example, using authority found in California Government Code section 5956 et seq. for a P3 project or the recently expanded design-build authority) and, in return, the private entity receives a steady cash flow from the improvement with user fees or other payments.

Professor Stephen Goldsmith, director of the Innovations in Government Program at the Harvard Kennedy School, recently wrote an informative "5-Part Test" on how to get a P3 project to the finish line (*Governing Magazine*, Dec.17, 2014). He provides a very thoughtful short list: (1) political will; (2) a belief in private-sector value creation; (3) underlying quality of assets; (4) commercially reasonable contract terms; and (5) a willingness to pay transaction costs.

However, in California and elsewhere, many excellent P3 opportunities are lost as local officials fail to get the potential P3 to the starting line. Before a public agency is prepared to discuss if a public-private partnership arrangement is appropriate, consideration must be paid to the major steps required prior to the start of any P3 proposal, negotiation or implementation. In short, an agency should first consider and agree upon the 4Ps: Problem, Project, Priorities and Politics.

1. What is the Problem to solve?

While it may seem obvious when an element of a local agency infrastructure is in need of repair or upgrade, it is not always apparent what is holding up the fix. Is it simply a lack of resources, insufficient taxing authority or a stifling regulatory environment? Or maybe it is a credit rating downgrade, debt or pension obligations? Maybe the agency seeks operating efficiencies, capital cost reductions or rate stability? Whatever the local issue is, it is best to get the problem well defined (and any other internal issues in order) before trying to entice a P3 partner to assist or even consider any particular fix, whether P3 or not.

2. What Project is needed to solve the problem?

Many opportunities may exist to solve an identified problem. But without arriving at a defined project, it can be difficult to efficiently identify and evaluate potential partners. It is critical for the public agency to take time to analyze the various alternatives, educate elected officials and members of the public on the nature of the problem and the various approaches to fixing it, and then develop a vision for the desired project. P3 is only one approach that can be utilized to deliver a project and should be considered along with other traditional approaches.

3. What are the Priorities of the community?

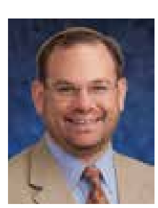
Where there can be clearly identified problems and projects, a community must also assess how this project and this problem compare with many other pressing needs. More than just prioritization of the project, agencies must look deeper and consider the various economic and risk factors for a given project. It is important to work with all parties to generate a common expectation and understanding of the process and timing of the negotiation and project delivery. Sometimes, agency staff or private parties can have expectations that do not match, which can lead to unnecessary challenges.

4. What is the Political environment for such a venture?

It is critical upfront to understand the political environment and various parties in and around a public-private partnership transaction — their goals, level of sophistication, risk tolerance, biases, etc. Some of the significant interested parties include: public agency elected officials, public agency staff / legal counsel, investors/developers, members of the public, special interest groups and regulators at the regional, state and federal levels. Moreover, many public agencies need to confront and overcome institutional bias from various outside consultants (financial, engineering, etc.) that may not have worked in a P3 context.

Finally, as the public-private proposal is being structured before being made public, make sure to prepare for success and build in elements to maintain transparency, keep open communication and regular interaction — as this is a marriage and every healthy marriage is based on open communication! Moreover, prepare for the P3 by making sure that the public agency has clarity on all required regulatory processes required for project approval (e.g. CEQA, NEPA, etc.) and an identified and secure revenue stream. Addressing these issues prior to the announcement of a P3 can also increase the amount of interest from investors and potential partners.

The 4Ps can help the public agency prepare for the private investor/developer to work more cooperatively on the public-private partnership. Understanding the 4Ps can also assist in the evaluation of the potential opportunity, working through the structure of the deal and then to implementation. Without a grounding in all these issues, parties can waste time and inflict great frustration on one another. We can do better! Our communities are counting on it. ▪



Seth Merewitz is a partner in the Los Angeles office of Best Best & Krieger LLP, and leads the Public-Private Partnership/Joint Venture Group. Seth provides advisory and transactional services to land developers, government agencies and private investors. His practice focuses on project development, land use and municipal law. Seth can be reached at seth.merewitz@bbklaw.com or (213) 787-2567.

A portion of this article first appeared on PublicCEO.com on Feb. 18, 2015. Republished with permission.