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PUBLIC-PRIVATE PARTNERSHIPS OFFER ALTERNATIVE MODEL FOR WATER INFRASTRUCTURE PROJECTS

In February 2012, the Commonwealth of Massachusetts completed a study of the state's drinking, wastewater, and stormwater infrastructure needs that identified a funding gap of at least \$39 billion over the next 20 years. The Water Infrastructure Finance Commission, which prepared the report, concluded that funding from traditional government sources is likely to decline over the same period. This scenario of rising infrastructure needs coupled with declining government resources is playing out in cities and towns across the country. As part of the solution to this funding gap, states and municipalities have been looking to public-private partnerships, or P3s, as an alternative to traditional methods of financing and delivering public infrastructure projects, including projects in the water sector.

In Massachusetts, cities and towns enjoy express authority to use alternative project delivery methods, although this authority is limited. Chapter 149A of the General Laws expressly gives municipal entities authority to procure public building and public works projects using "construction management-at-risk" and "design-build" methods, respectively, in lieu of the traditional design-bid-build procurement method. In order to qualify for Chapter 149A, the project must have an estimated construction cost of \$5 million or greater, and the municipality must receive approval from the Inspector General. To date, numerous school building projects have been approved and constructed using this express authority, but only one municipal public works project has used design-build procurement under Chapter 149A. For many cities and towns, the project cost threshold is a barrier to using Chapter 149A for water and wastewater projects, and Chapter 149A does not permit the use of private equity or debt financing to fund such projects. As such, Massachusetts municipalities must seek legislative approval to use alternative delivery methods that include a greater role for private partners and involve long-term contract operations, such as design-build, design-build-operate, and design-build-operate-finance delivery structures.

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The Massachusetts Legislature has routinely granted authority for the use of such project structures in cities and towns, particularly for water and wastewater treatment works. This authorization has been granted by special acts to more than a dozen cities and towns, including Lawrence, Lee, Provincetown and Springfield. These special acts typically include authority to enter into a contract “for the lease, operation and maintenance, repair or replacement, financing, design, construction and installation of new facilities or systems and modifications to existing facilities, necessary to ensure adequate services.” These special session laws authorize key elements of P3 deal structures and exempt the project from otherwise applicable public bidding and procurement laws (such as M.G.L. Ch. 7C, Secs. 44-57; Ch. 149, Secs. 44A-J; Ch. 149A; and Ch. 30, Sec. 39) and prescribe the selection process and certain contract conditions. This special act process, the only viable solution for most municipal awarding authorities, requires the submission of a Home Rule petition and a vote by the Legislature, thereby introducing uncertainty and possible delays into the public procurement process.

CONSIDERATIONS FOR STRUCTURING P3 AGREEMENTS

A broad spectrum of projects and deal structures may be classified as public-private partnerships, so there is no single, generally accepted definition. In general, the P3 concept involves a transaction based on contractual agreements between a public agency (typically a state or local entity) and a private sector partner that enables the particular skills and assets of each participant (public and private) to be shared in delivering a service or facility for the use of the general public, while also appropriately allocating risks and rewards. In all cases, P3 project structures allow for greater private sector participation in the financing and delivery of projects and typically offer incentives for efficiency and innovation in project finance and delivery.

What are the considerations for municipal stakeholders in public-private partnerships? There are policy concerns stemming from the impacts of P3s on labor and the public’s hesitancy to privatize aspects of infrastructure that have

traditionally been owned and operated by public entities. These complex issues require strong leadership to overcome. P3s that involve the use of public funds and relate to public assets clearly must be undertaken pursuant to a broad array of federal, state and local laws and regulations. Public-private partnerships require a legal and regulatory framework that protects the private partner’s financial investment and property rights while enabling commercial contracts to be legally enforced. Clarity regarding the types of P3s that are authorized, the types of projects that may be delivered using the P3 model, the method of selecting private partners, the scope of ancillary state laws and regulations that will apply (e.g., public bidding requirements, prevailing wages laws, bonding requirements, etc.) is critical to a successful process, as are the audit and oversight requirements that will be applicable to the private partner.

Legal challenges to the public-private partnership model can also be a significant risk to any project and should be thoroughly evaluated early in the project development process. Legal challenges have the potential to delay a project, impose mitigation requirements, or alter other fundamental aspects of a project. Such outcomes become more significant in a public-private partnership context because of their impact on project financing arrangements with multiple debt and equity parties. Legal challenges to P3 projects may include challenges based on public interest grounds, challenges to the procurement of the project and its compliance with the jurisdiction’s P3 enabling statute, or challenges relating to the environmental impacts of the project.

A significant headwind to the deployment of P3s is the complexity of the transactions, in particular the financial and legal agreements. The unique and custom nature of these transactions—no two are exactly the same with respect to the facility to be constructed, the financing schemes or the allocated risks—makes it challenging for project sponsors to realize economies of scale that are achieved with projects using traditional delivery methods that have standardized the full spectrum of project activities.

Consideration must be given to seven broad categories of risk common to P3 projects:

- Design/development risk
- Construction risk
- Revenue risk
- Financial risk
- Unexpected event risk (including political/regulatory risk)
- Performance risk
- Environmental risk

A well-drafted set of legal documents that details the allocation of these risks and other contractual obligations among the parties in a clear and precise fashion is critical for the success of a public-private partnership. A P3 agreement must govern a relationship that may last over a period of decades and must contemplate numerous variables and

details, so the partnership agreement must have clear provisions that establish a framework for dealing with a full spectrum of risks and disputes in a cost-efficient and equitable manner.

On the private side, P3s are costly and time consuming endeavors that require careful project development and market positioning efforts. Developers must also contend with each state's unique P3 enabling acts and regulatory frameworks that govern public-private partnerships as well as other laws and regulations that apply to construction, labor, real estate, and corporate matters, just to name a few. Because of these considerations, the P3 delivery model becomes more viable if used for a pipeline of projects, or smaller projects bundled into a single P3 transaction, so that the impact of transaction costs is minimized to the extent practicable.

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