

Public Private Partnerships: The Answer to the US's Infrastructure Issues?

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Agenda

- Are P3s the answer to the US's infrastructure issues?
- What is a P3?
  - Why are P3s being considered?
  - Advantages and benefits of P3s
  - Disadvantages and limitations of P3s
  - Criticisms of P3s
- Types of projects that can be procured using a P3
- P3 project delivery structures

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Agenda

- Financing P3 projects
  - Governmental bonds
  - Private activity bonds (PABs)
  - Transportation Infrastructure Finance and Innovation Act (TIFIA) and Water Infrastructure Finance and Innovation Act (WIFIA)
  - Transportation Investment Generating Economic Recovery (TIGER) Discretionary Grant program
  - Infrastructure for Rebuilding America (INFRA)
  - Capital Investment Program (New Starts)
  - State loan sources: State infrastructure banks; State Revolving Funds
  - Private sources of capital: Commercial loans; private placement and equity
- Trump Administration infrastructure proposal
- Examples of recent P3 projects

P3s: The Answer to the US Infrastructure Problem?

The short answer: yes and no.

During the course of this presentation we will discuss:

- Why P3s may work for certain projects.
- Why P3s cannot be used to meet all of the US's infrastructure needs.

What is a Public Private Partnership?

A long-term contract between a public agency and a private sector party (typically a consortium) in which:

- The public agency and the private sector party share in the risks and rewards of the project.
- The public agency leverages the private sector party's experience and efficiencies to deliver the project more efficiently:
  - The private sector party may be responsible for financing, designing, constructing, operating, and maintaining the project (or any combination of these services).
  - Depending on the project delivery structure used, private sector capital may be used to construct.

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What is a Public Private Partnership? (Cont.)

- The private sector party receives either:
  - Tolls/user fees or other project generated revenues (and takes the risk as to the amount and stability of these revenues).
    - Demand risk projects.
  - Periodic fixed payments from the public agency based on agreed performance criteria.
    - Availability payments projects.
- The public agency retains ownership of the project.

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Why are P3s Being Considered?

While the need for infrastructure investment is clear and widely accepted by politicians and other stakeholders, the source of the funds needed to develop, rehabilitate, operate, and maintain US infrastructure is less clear.

- Limits of the municipal bond market.

Most US infrastructure projects are financed in the municipal bond market. There is about $3.7 trillion outstanding in these bonds. But this financing source presents several issues:

  - Many states and localities are approaching their statutory, constitutional, or self-imposed debt limits.
    - While projects can be funded with bonds that are repaid with revenues generated from the project ("revenue bonds"), this requires a revenue generating project.
    - About 60% of municipal bonds are revenue bonds.
  - The participation of private sector parties is limited in municipal bond-financed projects.

Why are P3s Being Considered? (Cont.)

- Size of investment needed.

In March 2017, the American Society of Civil Engineers (ASCE) published its quadrennial Report Card for America's Infrastructure which:

  - Appraised the nation's overall infrastructure with a grade of "D+".
  - Estimated about $4.6 trillion is needed by 2025 to improve US infrastructure but only about $2.5 trillion is currently projected.

- Limited ability to raise taxes.
  - Lack of political will and public support.

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Why are P3s Being Considered? (Cont.)

- Reduced funding from the federal government
  - States receive disbursements from the Highway Trust Fund (HTF) to finance their surface infrastructure projects. But the amount in this fund is insufficient to meet their needs. HTF is funded with fuel taxes. BUT:
    - Tax has been set at 18.4 cents per gallon since 1993.
    - With fuel efficiency, lower amounts being raised.
    - HTF has needed periodic transfers from the Treasury's General Fund and other legislative acts to avoid insolvency.
      - ➢ Several states have raised their gas tax in recent years to help finance their infrastructure projects (for example, Pennsylvania, California, New Jersey, North Carolina, and Florida).

Advantages and Benefits of P3s

P3s:

- Free up public sector budgets.
  - Depending on the project delivery mechanism used, the private sector party may be responsible for financing and O&M costs.
  - Public agency does not need to have all the funds from the start.
  - Even in P3 structures where the public agency must make periodic payments to the private sector party, these payments:
    - Are stretched over a long period (on average between 30-50 years).
    - Are clearly set out, understood, and capped.
    - May be withheld if the project is not performing as expected.

Advantages and Benefits of P3s

- Shift significant risk to the private sector party.
  - The more activities that are performed by the private sector party, the greater the risk transferred.
    - Requires proper risk analysis and risk allocation.
- Leverage private sector expertise.
  - Many public agencies do not have the internal experience and expertise to manage large-scale infrastructure projects.
  - Operators with experience in other countries or states may have new ways or ideas for delivering the project.
- May result in faster project delivery.
  - One contractor facilitates communication and coordination and eliminates the different contract processes.

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Advantages and Benefits of P3s (Cont.)

- Private sector party is incentivized to complete the project in a timely and cost-efficient manner.
- Depending on structure, the public agency does not need to wait for appropriations, bond proceeds, or tax proceeds to finance the project.

- Provide life-cycle benefits. When one party is responsible for all aspects of the project, it is incentivized to:
  - Design the project to minimize construction defects.
  - Manage construction costs.
  - Build the project in a manner that minimizes operation and maintenance costs.

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Disadvantages and Limitations of P3s

- Cannot be used for all projects.
  - Project must be:
    - revenue generating to support demand risk projects or to provide support for availability payment projects.
    - if not revenue generating, important to public agency or the public. Public agency more likely to appropriate the funds to make the availability payments.
    - attractive to potential private investors: Want projects that can generate the required return.

May not be that helpful for:

- Smaller projects.
- Projects in rural areas.
- Projects that do not generate revenue (including critical water infrastructure).

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Disadvantages and Limitations of P3s (Cont.)

- Political risk
  - Projects get cancelled. This may happen even after private sector parties have incurred the costs of submitting a bid or project proposal. For example:
    - the Indianapolis Courthouse Project
    - the Illiana Expressway Project
    - the Virginia Route 460 Project

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Disadvantages and Limitations of P3s (Cont.)

- Absence of consistent P3 legislation, procurement procedures and documentation:
  - More than 30 states plus Puerto Rico and the District of Columbia have adopted some form of P3 legislation.
  - These statutes vary, including in terms of:
    - The projects that can be procured using P3s.
      - Some legislation allow P3s only to be used for transportation projects, while others provide government agencies with broad authority to use P3s for a variety of projects.
    - The method of compensating the private sector party.
      - Some legislation allow for availability payment structures while others are limited to demand risk projects.

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Disadvantages and Limitations of P3s (Cont.)

- The project delivery structures that can be used.
- The number of projects per year that can be procured using the P3 method.
- The term of any P3 agreement.
- The public agencies that can enter into a P3 agreement.
- The approvals required.
- The degree of community involvement required.

Practical Law has a tool that enables you to compare the P3 legislation in various states:

- Practical Law Finance, P3 State Q&A Tool: (http://us.practicallaw.tr.com/8-579-1870).

Disadvantages and Limitations of P3s (Cont.)

A project can be procured as a P3 even in states without P3 enabling legislation. This can be done through:

- Home rule authority
  - The $1.83 billion Chicago Skyway project.
  - Michigan's Freeway Lighting project.
- Special legislation
  - The Port Authority of New York and New Jersey is authorized under its procurement regulations to use P3s for its projects. It is delivering the Goethals Bridge Replacement Project and the Central Terminal Building Redevelopment Project at LaGuardia Airport under this legislation.
  - Illiana Expressway project (which was cancelled) was authorized by the Illiana Expressway Act.

Disadvantages and Limitations of P3s (Cont.)

- Lack of understanding about what a P3 is.
  - Many local and state officials do not understand this procurement method.
    - May be easier (or more politically palatable) to use design-build; design-bid-build structures.
  - Misunderstanding also extends to local populations that may be affected by the project.
  - The majority of P3s are concentrated in 4 states: Texas, California, Florida, and Virginia.
  - Some states have P3 legislation but have not procured or developed any projects under the legislation.

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Criticisms of P3s

- The public agency has lost control of the project.
  - This depends on the structure used.
  - P3 legislation and the P3 agreements typically give the public sector party extensive rights to monitor, audit, and oversee the project.
- Public financing may be cheaper.
  - Government entities can issue bonds to raise the funds needed to develop these projects. Interest on these bonds is tax-exempt which makes them a very attractive investment for many investors.
  - P3 projects may qualify for tax-exempt bond financing if certain conditions are met.
- The P3 process is too complicated and expensive.
  - The bidding process is costly.
  - Transaction expenses (lawyers and other advisors) can be significant.

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Criticisms of P3s (Cont.)

- The private sector party will increase the costs of using the project. P3 statutes and agreements typically:
  - Require any user fee increases to be approved by a public agency or to be subject to a public hearing.
  - Impose limits on the amount of any user fee increase.
- The private sector party may not maintain the project as required in order to save costs and increase returns. P3 statutes and agreements typically:
  - Require any P3 agreement that includes an O&M function to set out specific requirements for ensuring the project is properly maintained.
  - Allow the public agency to withhold payment or terminate the agreement if the project is not properly maintained.
  - Require the project to meet certain conditions before the operator can return operational control of the project to the public agency.

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What a Public Private Partnership Is Not

A broad P3 is not:

- A privatization
  - Public agency retains ownership.
- A panacea
  - Not for all projects.
  - A DB or O&M agreement may be more appropriate for certain projects.
- Not free money
  - Private sector party must be repaid from project revenues or the public agency.
- Not a funding source: but enables public agencies
  - Manage their limited funds.
  - Manage costs.
  - Access private sector capital to build their infrastructure.
  - Have more flexibility in structuring their projects.

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Types of Projects that can be Procured Using a P3

P3s can be used to:

- Construct or develop a wide range of transportation and social infrastructure projects, including:
  - Highways/toll roads
  - Bridges
  - Tunnels
  - Ports/airports
  - Water and wastewater facilities
  - Courthouses and civic buildings
  - Schools and university facilities
  - Hospitals
  - Parking facilities

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Types of Projects that can be Procured Using a P3

- Modify, rehabilitate, or expand existing infrastructure projects.
- Monetize existing underperforming infrastructure assets.

While P3s have mostly been used in the US to finance transportation projects, this procurement method is increasingly being used to finance social infrastructure such as:

- Government buildings (for example, courthouses).
- School facilities.
- Hospitals.

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P3 Project Delivery Structures

A P3 project may be structured in different ways depending on many factors including:

- The functions the private sector party will perform and the risks it will assume.
- The degree of operational control the public agency wants to have over any aspect of the project.
- The terms of any P3 enabling legislation. Some legislation specifies the projects that are eligible for the P3 structure and project delivery mechanism that can be used.

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P3 Project Delivery Structures (Cont.)

For example:

- Operation & Maintenance (O&M): Private sector party is only responsible for the O&M the project.
- Design-Build (DB): Allocates the least amount of risk to the private sector party and may not confer the life-cycle benefits that will help public agencies manage their costs.
- Design-Build-Finance-Operation-Maintain (DBFOM): Allocates the most risk and responsibility to the private sector party. Private sector party may be compensated from either:
  - Project revenues (for example, tolls).
  - Payments from the public agency (availability payments).

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P3 Project Delivery Structures (Cont.)

Contract Structure	Design	Construction	Finance	Operation	Maintenance	Ownership
Design-Build (DB)						
Operate-Maintain						
Design-Build-Finance (DBF)						
Design-Build-Operate (DBO)						
Design-Build-Maintain (DBM)						
Design-Build-Operate-Maintain (DBOM)						
Design-Build-Finance-Operate (DBFO)						
Design-Build Finance-Operation-Maintain (DBFOM)						

Government party: Blue

Private sector party: Red

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Financing Infrastructure Projects

P3 projects are financed from a variety of sources:

- Tax revenues.
- Government bonds.
- Private activity bonds (PABs).
- Transportation Infrastructure Finance and Innovation Act (TIFIA).
- Water Infrastructure Finance and Innovation Act (WIFIA).
- Transportation Investment Generating Economic Recovery (TIGER) Discretionary Grant program.
- Infrastructure for Rebuilding America (INFRA) grants.
- Capital Investment Program (New Starts).

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Financing Infrastructure Projects (Cont.)

- State loan sources.
- Private financing.
  - Commercial bank loans.
  - Private placement debt.
  - Equity.

There are more federal programs (whether grants or credit assistance) available for infrastructure projects. Counsel needs to examine the programs that work best for their projects.

Financing Infrastructure Projects: Governmental Bonds

These bonds are issued by public agencies to finance public infrastructure projects. These bonds are tax-exempt unless:

- More than the lesser of 5% or $5 million of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental persons; **OR**
- More than 10% of the proceeds of the bond-financed facility are used in the trade or business of a private entity ("private business use" limit) **AND**
- More than 10% of the debt service on the bonds is payable from or secured by payments to be made by a private, for-profit entity or revenue generated in connection with that entity's use of the bond-financed facility (the "private payment/security" limit).

Bonds that do not satisfy these requirements are private activity bonds (PABs) and taxable unless certain conditions are met.

The determination of what constitutes a governmental bond or PAB is based on IRS rules and regulations which should be closely reviewed.

Financing Infrastructure Projects: Governmental Bonds

There is currently more than $3.7 trillion outstanding in municipal bonds (with about $425-$450 billion in new issuances each year).

- Revenue bonds.
- General obligation bonds.

These bonds are used to finance:

- Schools.
- Courthouses.
- Jails.
- Libraries.
- Roads.
- Water and sewer systems and solid waste disposal systems.

Also used to finance stadiums:

➢ Although these bonds meet the private business use test, they do not meet the private payment/security test because these bonds are repaid by the relevant city or county.

Financing Infrastructure Projects: PABs

Debt instruments issued by a public agency on behalf of a private entity the proceeds of which are used to construct projects with significant private involvement. A bond qualifies as a PAB if both the private business test and the private payment/security test limits are exceeded.

Unlike governmental bonds, interest on PABs is taxable unless they are qualified private activity bonds (QPABs). This allows public agencies to shift some of the responsibility of managing public projects to a private entity while still allowing the parties to take advantage of the tax exemption and cheaper costs of financing.

QPABs include:

- Exempt facility bonds.
- Qualified mortgage bonds.
- Qualified small issue bonds
- Qualified redevelopment bonds.
- Qualified 501(c)(3) bonds.

(26 U.S.C. § 142)

Financing Infrastructure Projects: PABs (Cont.)

Exempt Facility Bonds

- Most relevant to infrastructure projects.
- These include:
  - airports
  - docks and wharves
  - mass commuting facilities
  - sewage facilities and solid waste disposal facilities
  - high-speed intercity rail facilities
  - qualified public educational facilities
  - qualified highway or surface freight transfer facilities

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Financing Infrastructure Projects: PABs (Cont.)

PABs:

- Must be issued under each state volume cap. The cap in 2017 is calculated as the greater of (a) $100 multiplied by the state's population and (b) $305,315,000.
- Subject to an overall cap of $15 billion.
  - The cap limits the number of projects that can be financed with PABs.
  - Some qualified PABs are exempt from the volume cap (for example, airports and docks).
  - Cap is not usually met.
  - States may carryover any unused allocations for a few years.

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Financing Infrastructure Projects: TIFIA

Federal program that provides credit assistance for qualified surface transportation projects of regional and national significance.

- Benefits of TIFIA.
  - Subordinate to other debt in the capital structure
  - Long tenors (up to 35 years)
  - Borrower-friendly financial terms
- Types of credit assistance.
  - Direct loans: up to 49% of total cost of an eligible project
  - Loan guarantees: up to 49% of total cost of an eligible project
  - Line of credit: up to 33% of total cost of an eligible project

Total Federal assistance (grants and loans) to a project receiving a TIFIA loan: up to 80%.

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Financing Infrastructure Projects: TIFIA (Cont.)

- Eligible recipients include:
  - State transportation departments
  - Public transit operators
  - Private entities
  - Local governments
- Eligible projects include:
  - Highways
  - Bridges
  - Public transit projects
  - Passenger rail projects

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Financing Infrastructure Projects: TIFIA (Cont.)

- Amounts available under the program:
  - 2016: $275 million
  - 2017: $275 million
  - 2018: $285 million
  - 2019: $300 million
  - 2020: $300 million

Regularly combined with tax-exempt debt (for example, PABs).

There is an equivalent program for water infrastructure projects (Water Infrastructure Finance and Innovation Act).

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Financing Infrastructure Projects: WIFIA

The WIFIA program:

- Modelled on TIFIA program and provides financing on substantially similar terms for qualifying water infrastructure projects.
- Has $28 million in funding authority (of which $3 million can be used for administrative purposes).
  - $20 million appropriated in December 2016.
  - $8 million appropriated under the Consolidated Appropriations Act of 2017.
- Administered by the EPA and the Army Corps of Engineers.

Water projects that qualify for WIFIA financing can also get funding under State Revolving Funds (SRFs).

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Financing Infrastructure Projects: WIFIA (Cont.)

- Began accepting applications in April 2017.
  - Received 43 applications and invited 12 projects in nine states to apply for loans under the program, including:
    - Miami-Dade County's ocean outfall discharge reduction and resiliency enhancement project, which requested $79 million.
    - San Francisco Public Utilities Commission's biosolids digester facilities project, which requested $625 million.
    - Baltimore's comprehensive infrastructure repair, rehabilitation, and replacement programmer project, which requested $492 million.

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Financing Infrastructure Projects: TIGER

- Competitive program under which the USDOT makes grants to the states for road, rail, and port projects.
- Initially appropriated under the **American Recovery and Reinvestment Act of 2009** with an initial award of $1.5 billion (TIGER I). Additional appropriations have been made as follows:
  - $600 million for TIGER II.
  - $527 million for TIGER III.
  - $500 million for TIGER IV.
  - $474 million for TIGER V.
  - $600 million for TIGER VI.
  - $500 million for TIGER VII.
  - $500 million for TIGER VIII.

The program is funded through 2019.

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Financing Infrastructure Projects: INFRA Grants

This grant program is a revision and rebranding of the Fostering Advancements in Shipping and Transportation for the Long-Term Achievement of National Efficiencies (FASTLANE) that was established 2015 under the FAST Act (Fixing America's Surface Transportation (Act (P.L. 114-94). As revised, the INFRA grant program:

- Provides financial assistance in the form of competitive grants to qualifying nationally and regionally significant freight and highway projects.
- Authorizes the DOT to make grants up to $1.5 billion in grants.

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Financing Infrastructure Projects: New Starts Program

- Discretionary funding program for the construction of new fixed guideway public transportation systems and the expansion of existing systems.
- Reauthorized from FY2016 through FY2020 as part of the FAST Act.
  - Funding is authorized at $2.3 billion per year, or about 19% of the overall federal public transportation program budget.
  - Unlike other major programs, funding comes from the general fund of the US Treasury, not the mass transit account of the Highway Trust Fund.
  - Subject to appropriation each year.

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Financing Infrastructure Projects: New Starts Program (Cont.)

- Eligible projects include:
  - Transit rail, including subway/elevated rail (heavy rail).
  - Light rail.
  - Commuter rail.
  - Bus rapid transit.
  - Ferries.

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Financing Infrastructure Projects: Commercial Loans; Private Placement Debt and Equity

In structures in which the private sector party is responsible for some or all of the project's construction costs, the private sector party often obtains (typically on a limited recourse basis):

- Commercial bank loans.
- Private placement debt (as initial financing or more commonly, to refinance commercial bank debt).

While interest on these facilities is taxable and these facilities are generally more expensive they are often necessary to complete the financing package.

- Equity in project company (about 15-20%).
  - Infrastructure funds.
  - Pension funds.

Trump Administration Proposals: Asset Recycling

Asset Recycling (also Asset Monetization)

State and local governments sell or enter into long term leases of their public infrastructure (such as roads and water systems) to private equity investors in exchange for cash to build new infrastructure.

- States and local governments use the funds to make other infrastructure investments.
- Federal government would pay a bonus to state or local governments that make these deals.
- Modelled on Australia's Asset Recycling Initiative.
  - Australia's federal government offered states and territories an incentive payment equal to 15% of the value of existing infrastructure assets procured through P3s, conditioned on the reinvestment of the proceeds in new infrastructure.

Query: Is Trump moving away from this and P3s generally?

Trump Administration Proposals: Asset Recycling (Cont.)

Asset recycling is not new in the US

Indiana Toll Roads (2006)

- Stretches 157 miles across the northern Indiana to the Illinois state line, where it connects to the Chicago Skyway and downtown Chicago.
- Winning bidder paid $3.8 billion for a 75 year-concession (about $1 billion more than next highest bidder) to operate the project. Also required to pay for capital improvements.
- Concessionaire filed for bankruptcy.
  - Overly leveraged financing structure ($4.1 billion in debt and $760 million in equity).
  - Inaccurate traffic forecasts resulting in lower revenues than expected.
  - Bad timing: Recession not long after.

But:

- Indiana used fee to pay down debt, fund a 10-year transportation capital program in ITR corridor, and deposited $500 million in trust fund for future transportation project.
- Concessionaire was sold for $5.7 billion for remaining 66 years of concession term.
- New concessionaire subject to same concession agreement and O&M obligations.
- Demonstrates private sector appetite for these types of assets.

Trump Administration Proposals: Asset Recycling (Cont.)

Chicago parking concession (2008)

- Winning bidder paid $1.157 billion (higher than the city's minimum) for a 75-year concession for the city's parking meters in a 100% equity deal.
- The city retains responsibility for rate setting, parking regulation enforcement and fine collection but rate increases were provided for in the first five years of the contract.
- City makes payments when meters are taken out of use (for example, construction and events).
- Concessionaire required to replace the coin-based meter system with a high-tech, multi-space/multipay meter system to facilitate payment via cash, credit, and debit cards and potentially other pay systems.
- City used funds for non-infrastructure related purposes (reserves, rainy day fund).
- Concern that city left money on the table:
  - The city took in $23.8 million from the meters in 2008, the last year before the concessionaire took over the system.
  - Revenue has increased by 368% since the private consortium took over the meters.
  - The concessionaire has reported since 2008 a total of $778.6 million in revenues. Expected to recoup the concession fee by 2020, with more than 60 years of meter money still to come.

Trump Administration Proposals: Asset Recycling (Cont.)

Chicago Skyway Project (2005)

- 7.8-mile toll road that links downtown Chicago with its south-eastern suburbs and the Indiana Toll Road.
- Winning bidder paid the City of Chicago $1.8 billion for the right to operate and maintain the elevated pike for 99 years.
- Financed with $1.2 billion in debt and about $650 million in equity.
- Concession company has about $2.3 billion in debt.
- In 2016, lease sold to Canada Pension Plan Investment Board (CPPIB), Ontario Municipal Employees Retirement System (OMERS), and Ontario Teachers' Pension Plan (OTPP) for $2.8 billion ($1.5 billion in equity, $425 million in bank debt and $975 million in project bonds).

Trump Administration Proposals: Asset Recycling (Cont.)

Issues

- Asset must be revenue generating.
- Long term lease presents a political issue.
- Must be the right project.
- Through due diligence and auction process to ensure best price.
- Must be willing to accept that concessionaire may overpay or underpay.
- Separate what asset earns under public management vs private management.
  - Could the public agency have made the capital and service improvements the private sector did?
  - Timing matters.
  - No guarantee (hindsight is 20/20).

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Trump Administration Proposals: 2018-2019 Budget

2018-2019 Budget

- Relevant department and agency cuts
  - DOT budget cut by about 12.7%.
  - EPA budget cut by 31.4%.
  - Corps of Engineers cut by 16.3%.

Consider impact of these cuts on federal environmental and permitting review.

Trump Administration Proposals: 2018-2019 Budget

- $200 billion for infrastructure over the next ten years
  - $5 billion in 2018.
  - Short of the $1 trillion campaign proposal.
  - No information of source of capital:
    - ➢ But makes clear that Federal government should have limited role in infrastructure.
    - ➢ Wants to shift more to the states and the private sector.
    - ➢ Campaign plan provided for a federal tax credit equal to 82% of equity investments made by a private sector party. The $1 trillion plan would require $167 billion in equity resulting in about $137 billion in tax credits.
      - ❖ States already pay about 75% of the costs of infrastructure projects.
      - ❖ Seemed to shift away from that based on comments made on September 27.

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Trump Administration Proposals: 2018-2019 Budget (Cont.)

- TIFIA program
  - $1 billion annually for 10 years
  - Proposes changes to eligibility requirements
- Eliminates TIGER program
- Highway Trust Fund
  - Reduces support by $95 billion by 2027
  - Would require the HTF to fund projects based only on fuel tax revenues

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Trump Administration Proposals: 2018-2019 Budget (Cont.)

- PABs.
  - Proposes eliminating the annual volume cap.
  - Proposes changes to eligibility requirements.
- Interstate highways.
  - Proposes eliminating restriction on tolling.
  - Proposes private sector investment to improve rest areas.
- New Starts Program.
  - Cuts funding by $928 million, or 43%.
  - Will support projects that have already signed funding agreements with the federal government, but wants to eliminate New Starts completely.

Trump Administration Proposals: 2018-2019 Budget (Cont.)

- WIFIA program
  - $20 million (lower than FY 2017 levels).
- State Revolving Funds (SRFs)
  - Clean Water SRF: $1.394 billion
  - Drinking Water SRF: $863 million (consistent with FY 2017)
- Privatizes Air Traffic Control operations
- Reduces funding for Amtrak by 50%
  - Eliminates funding for long-haul Amtrak routes

Trump Administration Proposals: Tax Plan

Tax plan

- One page proposal that is very short on details
  - Does not specifically address infrastructure
- Infrastructure relevant points
  - Reduces corporate and individual tax rates
    - Governmental bonds may be less attractive.
    - Impact of reduced rates and tax equity proposal for infrastructure unclear
  - Eliminates alternative minimum tax
    - Qualified PABs are exempt from federal income tax but still subject to AMT
  - Repatriation of corporate profits
    - Unclear how these profits will be used

Trump Administration Infrastructure Related Executive Orders

The majority of the action that has been taken on infrastructure involves a series of executive orders:

Executive Order	Summary
Executive Order Expediting Environmental Reviews and Approvals For High Priority Infrastructure Projects (January 24, 2017)	Established an executive branch policy to streamline and expedite environmental reviews of infrastructure projects (for example, projects to improve the electric grid and projects to repair and upgrade port facilities, airports, pipelines, bridges, and highways).
Presidential Executive Order Establishing a Presidential Advisory Council on Infrastructure (July 19, 2017) **Cancelled on August 17, 2017**	• To study the scope and effectiveness of, and make findings and recommendations to the President regarding, federal government funding, support, and delivery of infrastructure projects in several sectors, including surface transportation, aviation, ports and waterways, water resources, renewable energy generation, electricity transmission, broadband, and pipelines. • Was to include representatives from the communications and technology sector as well as real estate, finance, construction, transportation and logistics, labor, environmental policy, regional , and local economic development.
Presidential Executive Order on Establishing Discipline and Accountability in the Environmental Review and Permitting Process for Infrastructure ((August 15, 2017)	• To facilitate and streamline the federal environmental review and permitting process for infrastructure projects to eliminate inefficiencies, expedite infrastructure development and investment. and reduce costs. • Applies to assets (whether privately or publicly owned) that provide or support services to the general public in many sectors including surface transportation (including roadways, bridges, aviation, and ports), water and wastewater projects (including drinking water, stormwater, and sewer projects), and energy production.

Examples of Recent P3 Transactions

Project Name	Financial Close	Term	Project Description
Angels Flight Rail project	February 2017	30 -year DBFOM	Project to restore, operate, and maintain for Angels Flight, a funicular in downtown Los Angeles between Hill and Olive Streets on Bunker Hill.
Vista Ridge Water Pipeline Project	November 2016	30-year DBFOM	Project to build a 142-mile pipeline to deliver water to San Antonio from Burleson County, a water treatment plant, 18 wells , and three pump stations.
LaGuardia Airport Central Terminal Building (NY)	June 2016	35-year DBFOM	Project to demolish existing building and build new terminal.
Long Beach Civic Center (California)	April 2016	40-year DBFOM	Project to rebuild civic center including city hall, library, park , and port headquarters.
University of California Merced (California)	August 2016	39-year DBFOM	Project to expand campus facilities including academic, administrative, research, recreational, student residence, and student services buildings.
Purple Line LRT (Maryland)	June 2016	36-year DBFOM	Project to construct a 16-mile passenger rail link between Bethesda in Montgomery County and New Carrolton in Prince George's County, in the Maryland suburbs of Washington, DC. It will connect to Metrorail, the MARC Train, Amtrak , and local bus routes.
SH 288 Toll Lane (Texas)	May 2016	52-year DBFOM	Project to among other things, build four tolled lanes within the median of SH 288, construct up to eight direct connectors at Beltway 8 , and maintain and operate the general purpose lanes and associated facilities along the 10.3 mile section of SH 288.
I-285/SR 400 Improvements project (Georgia)	April 2016	DBF	Project to rebuild the I-285/SR 400 Interchange, a collector-distribution system north of SR 400 to Spalding Drive, and modifications of the existing north-facing ramps and Hammond Drive and reconstruction of the Abernathy Road interchange.
Loop 202 South Mountain Freeway project (Arizona)	February 2016	30-year DBM	Project entails the construction of a 22-mile, eight lane freeway (four lanes in each direction), including two HOV lanes, in the southwest quadrant of the Phoenix metropolitan area.

Examples of Recent P3 Transactions (Cont.)

Project Name	Financial Close	Term	Project Description
Kentucky Broadband project (Kentucky)	September 2015	30-year DBFOM	Project involves the laying over 3,000 miles of fiber optic cable to dramatically improve Kentucky's internet and cell phone services.
University of Texas, Dallas (Texas)	April 2015	DBFO	Project involves the design, build, finance and operate an on-campus mixed-use housing and retail development for the University of Texas at Dallas.
Detroit Freeway Lighting (Michigan)	August 2015	15-year DBFOM	Project to replace existing lights with energy-efficient LEDs.
Southern Ohio Veterans Memorial Highway (Portsmouth Bypass)	April 2015	30-year DBFOM	Project involves the development and long-term maintenance of an approximately 16-mile, four-lane limited access highway (to be designated State Route 823) around the City of Portsmouth in southern Ohio, bypassing approximately 26 miles of US 52 and US 23. It includes construction of 5 new interchanges and other related improvements.
I-77 HOT Lanes (North Carolina)	May 2015	50-year DBFOM	Project to widen and convert 26-mile section of I-77, north of I-85 interchange, from HOV lanes to all-electronic HOT lanes.
University of Georgia (Georgia)	May 2015	65-year DBFOM	Project to build campus housing.
Pennsylvania's Rapid Bridges project (Pennsylvania)	March 2015	28-year DBFM	Project involves the construction, reconstruct on or replacement of 558 bridges over a three-year period and then maintain them for 25 years.
US 36 Express Lanes/ BRT project (Colorado)	March 2014	50- year DBFOM	Project involves approximately 24 miles of managed lanes on US 36 between Boulder and Denver, including the I-25 Express Lanes.
I-4 Ultimate project (Florida)	September 2014	40-year DBFOM	Project covers approximately 21 miles of I-4, and entails adding four tolled express lanes (two in each direction), reconstructing 15 interchanges, replacing or reconstructing/widening 140 bridges and rebuilding the general use lanes along the entire corridor.

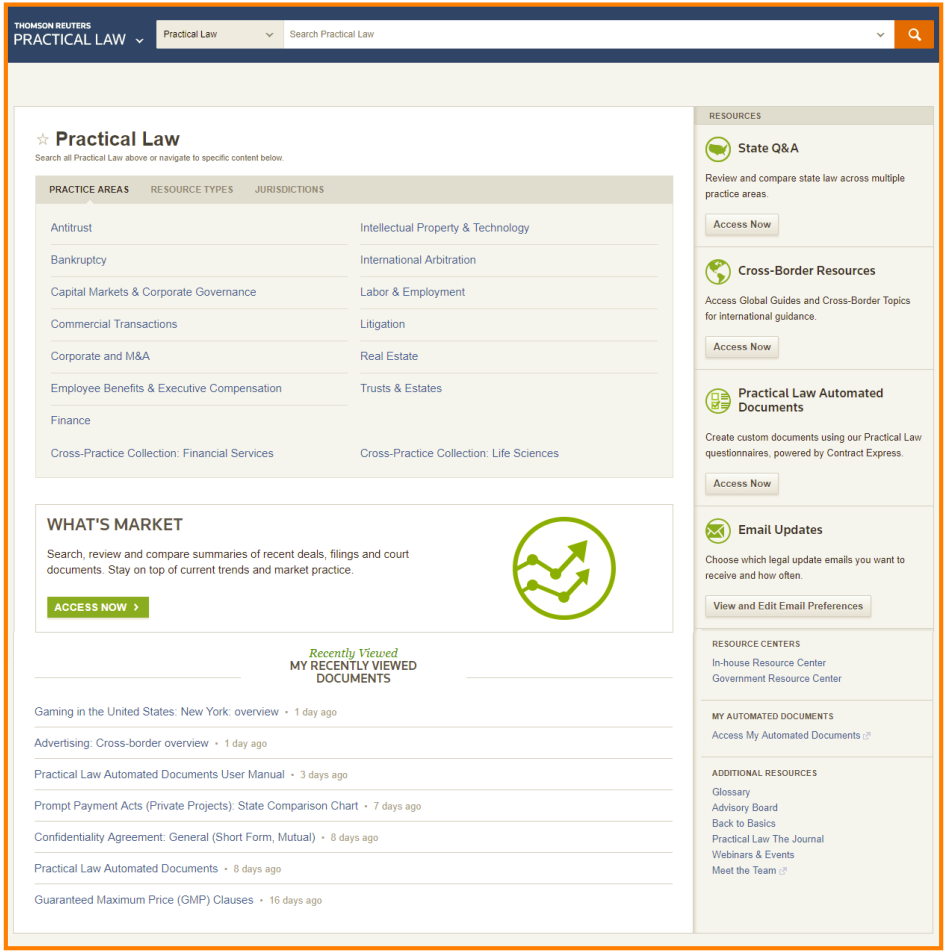
P3 Resources

- Practical Law Finance, P3 State Q&A Tool: (http://us.practicallaw.tr.com/8-579-1870).
- Practical Law Finance, Public Private Partnerships: Issues and Considerations: (http://us.practicallaw.tr.com/3-504-9995).
- Practical Law Finance, Negotiating Concession Agreements for Infrastructure Projects: (http://us.practicallaw.tr.com/7-506-2112).
- National Conference of State Legislatures (http://www.ncsl.org).
- Build America Bureau (https://www.transportation.gov/buildamerica).
- TIFIA Program Guide: Build America Bureau: Bureau Credit Programs Guide.
- WIFIA Program Guide: (WIFIA Program Handbook).
- Build America Transportation Investment Center (BATIC) Institute: an AASHTO Center for Excellence (http://www.financingtransportation.org).
- National Council for Public-Private Partnerships (http://www.ncppp.org).
- World Bank Public-Private-Partnership in Infrastructure Resource Center (https://ppp.worldbank.org/public-private-partnership).
- ASCE's Report Card for America's Infrastructure (Report Card) (http://www.infrastructurereportcard.org)

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Public Private Partnerships: Issues and Considerations

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A Note discussing public private partnerships (PPPs) including when they should be used to develop infrastructure projects. This Note also discusses the most commonly used PPP structures, alternatives to PPPs and how infrastructure projects (including those using a PPP structure) are typically financed.

When governments need to develop their physical and social infrastructure to provide necessary services to their citizens, they must decide how to procure and develop these projects. They can do any of the following:

- Finance, manage and oversee the construction, operation and maintenance (O&M) of the project themselves.
- Contract out discrete aspects of the project to different private sector parties (see, for example, Design-Bid-Build (DBB) and Management Contracts).
- Enter into a public private partnership (PPP or P3) agreement with a private sector party to perform all or material portions of the project.
- Sell the project outright to a private sector party (see Privatization).

Governments often do not want (or cannot afford) to assume full financial and operational responsibility for their infrastructure projects. These projects are capital intensive and governments may not have the resources, personnel and expertise necessary to develop and manage these projects. However, the privatization of the project may not be desired or appropriate (for example, for roads, highways and bridges or for assets that may have national security implications). As a result, governments are increasingly using P3s as a procurement method to develop their infrastructure.

P3s are complex and raise many issues. A full discussion of these issues is beyond the scope of this Note. Rather, this Note is an introduction to some of the key issues PPPs raise. In particular, this Note:

- Explains what a PPP is (see What is a Public Private Partnership?).
- Examines the benefits and drawbacks of PPPs (see Advantages of PPPs and Disadvantages of PPPs).
- Explores the issues governments typically consider before procuring a project as a PPP transaction (see When Should PPPs be Used?).
- Describes the other methods governments often use to develop their infrastructure projects (see Alternatives to PPPs).
- Discusses the use of PPPs in the US (see PPPs in the US).
- Discusses the most commonly used P3 structures (see Types of PPPs).
- Describes the methods for compensating private sector parties for their participation in a PPP project (see Structuring Payments under a PPP Agreement).

WHAT IS A PUBLIC PRIVATE PARTNERSHIP?

There are many ways in which the public and private sectors can cooperate to provide a public service. This may include a standard contract to provide certain services for a fee or public grants for certain projects. This Note uses a narrower definition of P3s that reflects the key reasons governments enter into these transactions and takes into account the distinctions between ordinary course government contracting and meaningful private sector participation in the project (see Advantages of PPPs). Fundamentally, a PPP is a long-term contract between a government (the local or national government) or government-owned entity (hereinafter referred to as a public agency) and a private sector party (typically a consortium) in which:

- The public agency leverages the private sector party's skills and assets to perform all or significant aspects of a project (for example, financing, design, construction and/or O&M).
- The public agency and the private sector party share in some fashion or another the risks and rewards of the project.
- The public agency retains some measure of control over the project (for example, contractual provisions giving the public agency the right to inspect and audit the project).
- The public agency retains ownership of the project.

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HOW ARE P3s USED?

PPPs can be used to:

- Construct or develop a wide range of infrastructure projects, including highways, power plants, bridges, prisons, pipelines, ports, waste treatment facilities, schools and hospitals.
- Modify, rehabilitate or expand existing infrastructure projects. When used for this purpose, the modification, rehabilitation or expansion is typically significant, requiring substantial new capital investment to justify the costs of structuring the project as a PPP.
- Monetize underperforming infrastructure assets to provide governments with much needed capital. When used for this purpose, the revenues the government earns from selling the right to operate the project (often referred to as a concession) must be sufficient to justify the PPP process and the loss of the project's ongoing revenues.

ADVANTAGES OF PPPs

Public agencies often prefer PPPs to other methods of infrastructure project delivery because of the advantages discussed below. However, depending on the project and the PPP structure used, not all of these advantages will be available.

Risk Transfer

PPPs allow public agencies to shift some or all of the risks of the project to the private sector party while retaining some measure of control over the project. Even in PPP structures in which the public agency is responsible for the financing, its liability is typically well-defined and limited (see Types of PPPs).

The Only Way the Project is Constructed at All

Because of budget constraints and governments' unwillingness and/or limited ability to raise taxes or incur debt to finance the project, the private sector party's participation may be the only way a project is built, expanded or modified. Even in P3 structures where the public agency makes payments to the private sector party, PPPs may be preferred because these payments are being made over time instead of all at once (see Availability Based PPPs and Shadow Toll Based PPPs).

Reduces Government Debt

US states and cities often issue bonds to raise the revenues required to develop their infrastructure projects and it can take decades to repay these bonds (see Bond Proceeds). If the private sector party is responsible for financing the project, the public agency receives a completed project at the end of the agreement without having to make the significant capital investment that would otherwise be required.

Budget Relief

Governments have limited resources and must decide on the projects that will receive financing. PPPs free up the public budget so that limited funds may be applied to other projects or budget or legislative priorities.

Cost Savings

In many P3 structures, the private sector is responsible for all aspects of the project. By having one entity responsible for all or significant parts of the project, the government can eliminate the costs of contracting with different parties and coordinating their rights and obligations. In addition, a private sector party that is responsible for designing, building, financing and operating the project will more likely consider the project's life-cycle costs instead of focusing on only its discrete part of the project.

Better Performing Assets

The private sector party typically incurs debt to finance the design, development and construction of the project and the revenues generated by the project are used to repay the debt. As a result, the private sector party has an incentive to ensure the project is built and performs well enough to repay the debt. In addition, the private sector party's lenders typically conduct a thorough analysis of the project's feasibility to ensure the private sector party can repay the debt. A contractor that has been paid for its services and that has limited warranty obligations may not be as concerned with these issues.

Avoids Underbidding

In a traditional DBB structure, a public agency awards the design contract and construction contract following separate public bidding processes (see Design-Bid-Build (DBB)). Some bidders may propose a low bid to win the contract and then require the public agency to pay significant amounts to make any changes to the project's design.

Shorter Construction Periods

Relying on public funding (whether funds from the Highway Trust Fund (HTF), a budget allocation or appropriation or government grants) may result in delays because the project may be put on hold pending the availability of these funds. (The HTF was set up under the Highway Revenue Act of 1956 (Pub. L. No. 84-627, 70 Stat. 374) and is funded using federal motor fuel, motor vehicle taxes, taxes on truck tires, sales of trucks and trailers, and heavy vehicle use.)

If the private sector party is financing the project with commercial bank debt or project bonds, the availability of these funds is typically a condition precedent to the execution or the effectiveness of the P3 agreement.

Technical Expertise

P3s allow public agencies to take advantage of the technical and professional expertise of the private sector. Some projects are highly technical and require specialized knowledge. Many governments, especially local governments, do not have the in-house expertise.

Minimizes Waste

Government contracts are often awarded to political cronies or for political reasons. The P3 contracting process is often more transparent than other types of public contracting because:

- PPP projects are typically conducted according to a statute that sets out the requirements for the project.
- Public agencies generally (and are often required under applicable law to) conduct extensive due diligence and analysis to ensure that a P3 is the most appropriate structure for the project.
- Public agencies must often convince the public and politicians that the PPP structure would be an efficient use of public resources or assets.

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Better O&M of the Project

With government operated and managed projects, the public agency may have obtained or allocated the necessary funds to construct the project, but they do not typically allocate for long-term O&M. To operate and maintain these projects, governments must periodically (typically annually) provide for the required amounts in their budgets. However, the government may have other budget priorities or limitations that undermine its ability to properly operate and maintain the project on an ongoing and long-term basis.

Revenue Generation

In the case of PPPs entered into for asset monetization, PPPs provide the government with much needed capital that may be used to meet other obligations. For example, in the Chicago Skyway project, the City of Chicago used $490 million of the $1.8 billion concession fee to redeem outstanding municipal debt and fund various city programs.

DISADVANTAGES OF PPPs

Some of the disadvantages of the PPP structure are set out below.

High Transaction Costs

Determining whether a PPP is appropriate for a particular project takes time and expense (see Value for Money (VfM) Analysis). In addition, the costs of negotiating and drafting the PPP project documents are significant. However, these costs can be managed by standardizing PPP procedures and agreements through P3 enabling legislation. See, for example:

- State Q&A: Public Private Partnership Legislation: California (9-554-3318).
- State Q&A: Public Private Partnership Legislation: Maryland (1-544-8565).
- State Q&A: Public Private Partnership Legislation: Pennsylvania (0-539-8127).
- State Q&A: Public Private Partnership Legislation: Ohio (8-519-1948).

To compare the terms of these and other state P3 legislation, see Public Private Partnership Legislation: State Q&A Tool.

There are also many initiatives in place to standardize the contracts used in these transactions and to educate state and municipal employees on how to procure projects using P3s (see, for example, FHWA Office of Innovative Program Delivery and Build America Transportation Investment Center (BATIC).

Higher Financing Costs

In many cases, a public agency can obtain financing at a lower interest rate (typically 2% to 3% lower) than private sector parties. This is due to several reasons:

- Public debt is typically tax-exempt.
- Holders of public debt believe that a default by the government or a government-owned entity is less likely (even if the debt is not backed by the full faith and credit of the applicable government).

However, this disadvantage may be outweighed by the advantages of the P3 procurement method (such as lower costs over the life-cycle of the project and greater efficiency). In addition, the PPP may be structured so that the public agency obtains the financing (thereby possibly benefiting from the lower financing costs) while allocating many of the other risks (for example, construction cost overruns and raw material supply risks) to the private sector party (see, for example, Design-Build-Operate (DBO)). In addition, in certain jurisdictions, a government entity may be able to issue tax exempt bonds on behalf of the private sector party (see Financing an Infrastructure Project).

Loss of Operational Control

In many PPP structures, the government delegates significant control over the project to the private sector. However, PPP agreements typically give the public agency extensive monitoring and auditing rights to ensure the project is properly operated and managed.

Loss of an Ongoing Revenue Source

In demand risk projects, the public agency forgoes the right to earn revenues on an ongoing basis from the public's use of the project for the term of the P3 agreement. However, depending on the project's payment structure, the government might receive a lump sum payment when the PPP contract is entered into or a share in the project's ongoing revenues. In any event, the lost revenues cannot be evaluated in a vacuum because the public agency often also forgoes the expense of operating and maintaining the project.

Higher User Fees

In asset monetization PPPs, the fees paid by the users may be higher than those they paid when the project was government operated and managed (for example, higher tolls). This may be because the private sector party needs to recoup the fee it paid for the concession and make a profit. However, these projects may be better maintained and operated.

But these fees can be managed by:

- Including restrictions in the PPP agreement regarding fee increases. These may include executive or legislative approval for any increase in user fees.
- Making the bidding process more efficient. A high bid may be good in the short term, but if too high the private sector party may not be able to operate and maintain the project and repay the debt it incurred to pay the bid price. This may result in renegotiation of the PPP agreement or abandonment of the project (see Practice Note, Negotiating Concession Agreements for Public Infrastructure Projects (7-506-2112)).

WHEN SHOULD PPPs BE USED?

PPPs are not appropriate for all projects. To determine whether a PPP is the best method for procuring a particular infrastructure project, public agencies typically evaluate:

- Whether the proposed project will provide a service or benefit that is best provided by the government. The answer depends in part on the nature and location of the project, the expectations of the public and the political climate in which the public agency operates.
- The capital investment required to build, operate and maintain the project. PPPs are typically appropriate for large-scale projects that involve significant capital investment that may be beyond the public agency's capacity.

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- Whether the public agency can afford to forgo the revenues it would receive if it operated the project.
- In the case of PPPs being entered into for asset monetization, the amount of the upfront payment the public agency receives and the uses to which these funds are applied. The fee can be used to retire debt, provide services and invest in other infrastructure projects.
- Whether the public agency has or will have the funds necessary to operate and maintain the project on an ongoing and long-term basis.
- The technical and technological requirements of the project. If these are beyond the expertise of the public agency, it may be better to allocate the design and construction risk to a third party.
- Whether a private sector party may be a more efficient service provider.
- Whether operational controls can be established to monitor the private sector party to ensure that the service is provided properly to the public.

To assist the public agency in making this evaluation and in determining whether a PPP is a viable option, many public agencies also conduct a value for money analysis (see Value for Money (VfM) Analysis). In many jurisdictions, the PPP legislation requires this evaluation.

VALUE FOR MONEY (VFM) ANALYSIS

A VfM analysis measures the relative costs of a project if it is procured using traditional public procurement methods versus a PPP to determine the best value for the public agency. This analysis is not simply a determination of the approach that is initially cheaper. Rather, it is a comparison of the costs and benefits of traditional government contracting versus the costs and expenses of a PPP structure over the life of the project. This comparison takes into account:

- The net present costs of the project over its entire useful life, including:
  - financing, design, construction and O&M costs; and
  - any payments the public agency may be required to make to the private sector party (see Availability Based PPPs and Shadow Toll Based PPPs).
- The risks that would be retained by the public agency, transferred to the private sector party, or shared between the two parties, including:
  - construction costs overruns;
  - higher than expected O&M costs;
  - demand risk (the risk that the public will not use the project to the extent required); and
  - collection risk (the risk that the project's end users will not pay for the service).
- The net present value of the payments the public agency would receive from the private sector party or the project's end users over the life of the project (for example, the fee for entering into the PPP agreement or ongoing royalties) if it operated the project.
- The skills and expertise the private sector party brings to the project.
- The public's ability to pay any user fees that may be required. In some PPP structures, the private sector party obtains third-party loans to finance the performance of its obligations under the PPP agreement. These user fees (taking into account the term of the agreement and a reasonable level of use) are typically calculated to enable the private sector party to repay these loans and other costs.
- Whether in the absence of private sector participation, the project would be developed at all.
- The residual value of the project at the end of the term of the PPP agreement.

ALTERNATIVES TO PPPs

Other than PPPs, governments can choose to deliver an infrastructure project by:

- Outsourcing certain services (see Service Contracts).
- Entering into management contracts for certain services (see Management Contracts).
- Entering into consulting agreements with a private sector party (see Engineering, Procurement and Construction Management Agreement).
- Entering into separate design and construction contracts (see Design-Bid-Build (DBB)).
- Selling the facility to a private sector party (see Privatizations).

SERVICE CONTRACTS

In this structure, the public agency contracts with a private sector party to provide specified services for the project (for example, operations and/or maintenance). These agreements are typically short term (one to three years) and involve no fixed asset investment by the private sector party. In exchange for providing this service, the private sector party receives a service fee. The public agency retains ownership and is responsible for all other aspects of the project (including higher than expected construction or O&M costs).

MANAGEMENT CONTRACTS

In this structure, the public agency finances, designs and constructs the project, and enters into an agreement with a private party to operate, maintain and manage the project in exchange for a fee. These agreements are typically two to five years but may be longer for more complex projects. In certain cases, the private sector party may assume some commercial risks with respect to the O&M and management operations. The public agency retains ownership of the project and has responsibility for all other aspects of the project.

ENGINEERING, PROCUREMENT AND CONSTRUCTION MANAGEMENT AGREEMENT

This is a professional services agreement between a consultant and the public agency pursuant to which the consultant provides the project's design and manages the construction process on behalf of the public agency. For more information on this type of agreement, see Practice Note, Understanding Project Finance Construction Contracts (1-422-1870).

DESIGN-BID-BUILD (DBB)

In the DBB model, which is the traditional method of developing infrastructure in the US, the public agency contracts separately for the design and construction of the project with different private sector parties following sequential public bidding processes. After

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the designs are completed, the public agency engages a contractor to build the project based on the designs. The contractor is not required to evaluate the designs and is allowed to assume that they are correct and reflect the public agency's needs for the project. As a result, if there is a defect in the design of the project that affects construction costs, the public agency may have to pay for the costs of correcting the defect. The public agency may be able to sue the project's designer to recoup these costs but the claim may mature after the warranty period has expired or exceed of the designer's warranty obligations. The public agency also bears the risk associated with the financing and O&M of the project.

PRIVATIZATION

In a privatization, the public agency sells the asset to the private sector party who is responsible for all aspects of the project. Although the asset is now fully privately owned, depending on the nature of the project or the service being rendered, the public may still hold the public agency ultimately accountable for the way the project is managed or the service is provided.

PPPs IN THE US

PPPs are used extensively worldwide but they are not used to the same extent in the US. Most projects in the US are developed using the DBB project delivery mechanism. However, P3s are increasingly being used in the US because of the financial constraints governments are facing.

Private companies have always been involved in the construction of roads and other infrastructure facilities, but their involvement declined in the last 50 years following the implementation of the federal HTF to finance transportation infrastructure projects.

RESISTANCE TO PPPs IN THE US

There is a lot of resistance in the US to using PPPs. The reasons for this resistance include concerns that:

- Public assets would be operated by private parties who will not properly maintain them in order to maximize their profits. However, PPP agreements typically have extensive provisions regarding O&M of the project. Some of these provisions include:
  - setting out a detailed maintenance and repair schedule;
  - specifying performance standards with which the private sector party must comply and methods for measuring and ensuring compliance;
  - authorizing the right of the public agency to approve the O&M operator selected by the private sector party;
  - establishing an O&M reserve account to ensure that funds are available to make necessary improvements and repairs;
  - authorizing the public agency to audit and inspect the project facilities;
  - authorizing the public agency to withhold payments to the private sector party following an event of default or to require payments from the project's end users to be deposited in a segregated account; and
  - authorizing the public agency to step in to operate the project and undertake repairs and charge the cost of these repairs to the private sector party (by deducting these amounts from fees owed or applying tolls received from the project's end users depending on the fee structure, see Structuring Payments under a PPP Agreement).
- An asset of national security significance will be controlled by a foreign entity. However, mechanisms are in place to regulate foreign ownership of sensitive US assets (see Article, Clearing Foreign Investment in US Businesses through the Committee on Foreign Investment in the United States (7-384-7097)).
- Transferring a project's future revenues to the private sector disadvantages taxpayers who no longer benefit from these funds. This criticism can be offset if the public agency:
  - makes an effort to inform the public of the benefits of the project, including the funds it will receive from the private sector party; and
  - conducts a thorough and complete VfM analysis (see Value for Money (VfM) Analysis).
- Using the project will become more expensive (for example, the private sector party will increase tolls). However, PPP agreements typically include extensive provisions regarding user fees. For example, the agreement may:
  - provide that the user fees are fixed for a certain period of time after closing and thereafter subject to adjustments in accordance with the Consumer Price Index, a fixed percentage or other applicable index; or
  - require that any increases be approved by the government or implemented following a public hearing or a comment period. It should be noted that many project participants resist this approach because of the time it takes and the potential of turning price increases into a political issue.

Notwithstanding these concerns, public agencies are increasingly using PPPs to develop their projects because:

- Of the dire state of US infrastructure. In 2017, the American Society of Civil Engineers issued a report grading US infrastructure a "D+" and requiring an investment of $4.590 trillion. However, only $2.526 trillion in infrastructure spending was projected, leaving a $2.064 trillion shortfall. While an improvement from the 2013 report, where $3.6 trillion was needed, this still leaves a significant funding gap (see Legal Updates, The American Society of Civil Engineers Releases 2017 Report Card on US Infrastructure (w-006-9040) and The American Society of Civil Engineers Releases 2013 Report Card on US Infrastructure (5-525-3278)).
- The HTF is insufficient to meet their infrastructure needs and an increase in the taxes that fund the HTF is politically impractical.
- Budget constraints and other funding priorities prevent public agencies from using other sources of revenue to develop these projects.

National politicians have recognized the need to increase funding of, and encourage private investment in, the US's public infrastructure system and have proposed various legislation to address this need, although to limited effect.

States have also responded to the infrastructure crisis by implementing PPP enabling legislation. More than 30 states plus Puerto Rico have implemented some form of PPP enabling legislation and PPP legislation is pending in several others.

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The scope of this legislation varies widely from one state to another including with respect to:

- The projects that can be the subject of a PPP agreement.
- The PPP structures that can be used.
- Whether a VfM analysis is required and, if so, the extent of that analysis.

Counsel engaged in a PPP transaction should, therefore, carefully review the applicable legislation to ensure they well versed on the requirements (see Public Private Partnership Legislation: State Q&A Tool).

If the public agency is a city or other local jurisdiction, counsel should also make sure they understand any applicable municipal or county ordinance or other authority under which the project is being implemented. This is because where PPP legislation has not been implemented, many local jurisdictions have broad authority to engage in these transactions under constitutional home rule powers or otherwise.

GOVERNMENT FINANCING OF INFRASTRUCTURE PROJECTS IN THE US

If a public agency decides to either be primarily responsible for the infrastructure project by contracting with private parties for discrete parts of the project (see Service Contracts or Design-Bid-Build (DBB)) or use a PPP structure that allocates financing of the project to the public agency (see, for example, Design-Build-Operate (DBO) or Build-Own-Operate-Transfer (BOOT)), they can use:

- Tax revenues (see Tax Revenues);
- Bond proceeds (see Bond Proceeds);
- Commercial bank loans (see Commercial Bank Loans); and/or
- Grants from the national government (see Grants).

Tax Revenues

States often use dedicated tax revenues (state fuel, motor vehicle and motor carrier taxes in the case of infrastructure projects) or general public funds to build infrastructure projects. These revenues are often insufficient, however, to meet the state's infrastructure needs and raising taxes may not be politically or economically viable.

Bond Proceeds

State and city governments are able to issue tax-exempt bonds to finance infrastructure projects. This financing mechanism has several drawbacks, however, including:

- Although the bond proceeds may be sufficient to design and construct the project, they may not be enough to pay for the project's ongoing O&M costs. In addition, though the public agency receives revenues from the public for using the project (for example, tolls or electricity payments), these revenues may not be applied to operate and maintain the project. They may be used to repay the bondholders or to pay for other government priorities.
- There may not be sufficient investor appetite for the amount of funding the project requires.
- The bond documents may impose limitations that raise budget and policy issues for the applicable public agency.
- There may also be limits (constitutional or budgetary) as to the amount of debt the public agency can incur.

Commercial Bank Loans

Governments do not use commercial bank loans as often to finance their infrastructure projects because:

- These loans are usually made on a short-term basis and the construction periods of infrastructure projects are typically longer. The public agency may obtain construction only loans but they would bear the risk of refinancing and taking out these loans with more permanent financing in line with the project's revenue flow.
- Loan agreements typically include extensive affirmative, negative and financial covenants to which a public agency may not want to be subject.
- Similar to bonds, the government may be subject to debt incurrence restrictions.

Grants

States receive funds from the federal government to finance their infrastructure projects, including disbursements from the HTF.

TYPES OF PPPs

There are many PPP structures and the structure used for any particular project depends on:

- The functions (design, construction, financing, operation and/or maintenance) the private sector party will perform and the risks it will assume.
- Whether the project is a new build or a modification or monetization of an existing facility.
- The degree of operational control the public agency wants to have over any aspect of the project.
- The nature of the project. If the project involves an asset important to national sovereignty or security or a service that is viewed as a core responsibility of the government, the PPP may be structured to allow the private sector party to lease or operate the project but never own it.
- Whether the private sector party will own the project assets at any time during the term of the agreement.
- Whether the project will have any residual value at the end of the agreement.
- The terms of any PPP enabling legislation. Some legislation specifies the projects that are eligible for the PPP structure and delivery mechanism that can be used.

Set out below is a discussion of the most common PPP structures. There are no universally accepted definitions for these terms and different terms are often used to refer to the same structure depending on the jurisdiction. When reviewing and drafting PPP enabling legislation and agreements, counsel should not focus on the title of these agreements but rather on the specific obligations and risks assumed by the private sector party.

In many of the structures discussed below, the public agency is responsible for financing the project's construction. The scope of the public agency's liability in these structures is generally

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different, however, than in non-PPP structures. For example, in non-PPP structures, the public agency is generally responsible for all construction costs including any costs overruns. In addition, the public agency may also have to pay to correct any design or construction defects (see Design-Bid-Build (DBB)). As a result, the public agency cannot be sure of the extent of its financial exposure. This is especially an issue if the public agency is relying on limited tax revenues or grants to pay these costs. The public agency has a better sense of its financial exposure in a PPP project because the amount it pays to the private sector party to construct the project is typically determined in advance and is generally fixed. If additional funds are required to complete construction, the private sector party is typically required to make up the shortfall.

DESIGN-BUILD (DB)

This is the most basic of the PPP structures (and the most commonly used in the US) and allocates the fewest obligations and risks to the private sector party. In this structure:

- The private sector party designs and constructs the project for a fixed fee payable by the public agency. Because one party is responsible for design and construction, unlike in the DBB structure, there are no issues as to the party who bears the design risk.
- The public agency is responsible for financing but saves the costs and time of entering into separate contracts.
- The public agency owns the asset and is responsible for O&M of the project. The public agency can either enter into an O&M agreement with a private sector party or do the O&M itself using internal resources.

DESIGN-BUILD-FINANCE (DBF)

In this structure, the private sector designs, builds and provides full or partial financing for the construction of the project and the public agency is responsible for the O&M of the project. This structure raises several issues, including:

- Because the private sector has limited responsibility post-closing (for example, warranty obligations for a certain period), it may not take a life-cycle approach to the design and construction of the project.
- The public agency retains the risk of the project's operations, including issues that may arise because of design and construct defects. While the private sector party has warranty obligations, these may not be enough to compensate the private party for the higher O&M costs.

DESIGN-BUILD-OPERATE (DBO)

This structure is similar to the DB structure, except that the private sector party also operates the project. Operating a large-scale project often requires a lot of technical expertise and significant investment in personnel that the public agency may not have. This structure enables the public agency to shift this responsibility to the private sector party. The public agency is responsible for financing the project's construction and maintenance costs.

DESIGN-BUILD-MAINTAIN (DBM)

This structure is similar to the DB structure, except that the private sector party also maintains the project. The public agency pays an agreed amount for these services and if more funds are required, it is typically the responsibility of the private sector party. Maintenance of the project can be expensive and being able to shift responsibility for repairs to the private sector party can result in significant cost savings to the public agency. In addition, knowing that it will be responsible for maintaining the project may result in the project being built to a higher standard to reduce maintenance costs.

DESIGN-BUILD-OPERATE-MAINTAIN (DBOM)

In this structure, the private sector party is responsible for (and bears the risks associated with) the design, construction and O&M of the project. The public agency maintains ownership and is responsible for financing the construction of the project. The private sector party may be paid from the project's end users or the public agency (see Structuring Payments under a PPP Agreement). The advantage of this structure over the DBO and DBM structures is that both operations and maintenance of the project are already provided for. In cases where the public agency is responsible for either or both of these, it may not have the funds available in its annual budget to do so which may cause the project to fall into disrepair.

DESIGN-BUILD-FINANCE-OPERATE (DBFO)

This structure is similar to the DBO structure except that the private sector party is also responsible for financing the project. Title to the project remains with the public agency. The private sector party may be paid by the public agency or from fees collected from the project's end users (see Structuring Payments under a PPP Agreement).

DESIGN-BUILD-FINANCE-OPERATE-MAINTAIN (DBFOM)

Under this structure, the private sector party is responsible for designing, building, financing, operating and maintaining the project for a specified period. The project is owned by the public agency. This structure:

- Allocates the most risk to the private sector party.
- May be the most efficient because the private sector must take a life-cycle approach to the project to ensure it minimizes the costs of operating and maintaining the project.

The private sector party may be paid by the public agency or from fees collected from the project's end users. If it is paid by the users, the private sector party also bears demand and revenue risk. For more information, see Structuring Payments under a PPP Agreement.

DESIGN-BUILD-FINANCE-OPERATE-MAINTAIN-TRANSFER (DBFOMT)

This structure is similar to the DBFOM model, except that the private sector owns the asset for the term of the PPP agreement after which ownership, operations and maintenance are transferred to the public agency.

LEASE, DEVELOP AND OPERATE

In this model, which is typically used for existing or brownfield projects, the private sector party leases an existing facility from a public agency, invests its own capital to renovate, modernize and/or expand the facility. Then, the private sector party operates and maintains the project under a contract with the public agency. In exchange for assuming these obligations, the private sector party is typically entitled to receive payments from the public for use of

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the facility. This may be used when vesting title to the assets in the private sector party for any period may be not appropriate or desired.

CONCESSION

In a concession, the public agency sells to a private sector party the right to operate and maintain an existing project for a specified time which can be for as long as 99 years (for example, the $1.8 billion Chicago Skyway project has a concession term of 99 years and the $3.8 billion Indiana Toll Road project has a concession term of 75 years). In exchange for operating and maintaining the project, the private sector party is entitled to receive payments from the end users of the project (for example, tolls). In this structure, the public agency continues to own the project assets and control of the project reverts to it at the end of the concession term.

STRUCTURING PAYMENTS UNDER A PPP AGREEMENT

The payments the private sector party receives for performing its obligations under the agreement may be structured several ways. The payment structure used depends on:

- The party who will assume the demand and collection risks (see Value for Money (VfM) Analysis).
- The amount of the tolls or user fees rates, including whether the public can be required to pay these fees.

The private sector party may be paid:

- A fixed fee by the public agency once the project is ready and available for use (see Availability Based PPPs).
- A variable fee by the public agency based on the public's usage of the facility (see Shadow Toll Based PPPs).
- A fee by the project's end users (see User Fee PPPs).
- A combination of any of the above.

This section provides an introduction to the issues raised by the different payment arrangements PPPs can include. For a more detailed discussion of these structures and the issues to consider when structuring and drafting the payment provisions, see Practice Note, Negotiating Concession Agreements for Public Infrastructure Projects (7-506-2112).

AVAILABILITY BASED PPPs

In this fee structure, the public agency makes payments to the private sector party once the project or facility is available for use (subject to compliance with the agreed performance criteria and standards). The public agency bears the demand and collection risks under this structure because the amount it pays to the private sector party does not change even if the project is not used to the extent anticipated. The public agency may be able to offset the availability fee with user fees received from the public. However, whether or not it actually collects these fees has no effect on its payment obligations to the private sector party. As a result, this fee structure relies (and can impose significant pressure) on the public budget. However, paying availability fees over the life of the project may be preferable to making the capital investment necessary to build the project.

Although demand risk is not an issue for the private sector party, this structure does raise other concerns, including:

- If budget approval is required for the public agency to make the availability payments, is there a risk that such approval may not be given in a timely manner or at all? Is this approval subject to any conditions?
- Is there a likelihood that the public agency may breach its obligations under the agreement? Depending on the location of the project, the private sector party should consider obtaining political risk insurance (see Practice Note, Political Risk Insurance: Is it Necessary? (5-503-9151)).
- What is the likelihood that the public agency will become unable to pay its debts?
- If the public agency is a government owned entity, are its obligations guaranteed by the government?
- How is availability defined? If the project must be taken out of service because of a force majeure event, for repair or at the request of the public agency, what obligations does the public agency have to make these payments?
- Is the public agency party to any other P3 agreements that require them to make availability payments? The more of these agreements that exists, the greater the budget pressure.

SHADOW TOLL BASED PPPs

Typically used for transportation projects, shadow tolls are per vehicle amounts paid to the private sector party by the public agency and not the users of the facility. This is used when it may not be feasible for the road to include toll facilities. The more the road is used, the higher the payments the public agency is required to pay to the private sector party. These payments can, therefore, impose a significant burden on the public agency's finances. To minimize this pressure, many agreements include a cap on the amount the public agency is required to pay. In this structure, the private sector party and the public sector share the demand risk.

This structure raises some of the same issues discussed above (see Availability Based PPPs). In addition, the private sector should take steps to ensure that:

- The project is used as expected.
- The government does not construct a competing project that may reduce demand (although public agencies generally resist or are precluded from agreeing to non-compete provisions).
- The government does not adopt legislation (for example, zoning changes) that reduce demand.
- Use of the project can be independently verified.

USER FEE PPPs

In this structure, the end users pay the private sector party for the use of the facility (for example, tolls). As a result, the private sector party bears the demand and collection risks. To mitigate these risks, private sector parties:

- Conduct extensive traffic and other applicable studies to determine the reasonable level of use that can be expected.

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- Require the public agency to agree not to build a competing project or implement legislation that may adversely affect demand.
- May require the public agency to guarantee a certain level of use and make payments to the private sector party if such minimum amount is not achieved.
- Include in the PPP agreement extension or renewal provisions to allow the private sector party sufficient time to recoup its investment and earn a return.

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