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Best Practices for Public-Private Partnerships

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Public-private partnerships (P3s) for public infrastructure are likely to become more prevalent due to necessity, if nothing else. In anticipation of this uptick in P3s, this article examines "best practices" for public partners' P3 programs, which contractors need to understand to better appreciate the risks and rewards that P3 projects entail.

At their core, P3 projects involve private financing and the sharing of a project's risks and rewards by private and public partners beyond the construction phase.

Building new projects or rehabilitating existing facilities on a P3 basis generally means that such projects get built quicker, better, and at a lower cost than if the project were built under a traditional design-bid-build basis with public funds. Accordingly, public agencies need to develop their P3 programs with the goal of attaining as many of the potential benefits that P3 projects offer.

The overall premise supporting the development of infrastructure projects under a P3 approach is that public projects can benefit from the private sector's involvement in terms of innovations, efficiencies, and state-of-the-art practices for design, construction, operation and maintenance of such projects. Initially, however, a P3 program should focus on whether a particular project being contemplated should proceed on a P3 basis or a traditional, publicly-funded basis.

Value for Money Analysis

After conducting a feasibility study and making the business case for developing the project, the determination of whether

to proceed on a P3 basis focuses on a rigorous value for money (VfM) analysis for the project's entire lifecycle. The VfM for delivery under a P3 method needs to be compared to the VfM for delivery under a traditional method. If the VfM analysis does not support a P3 approach, it should not be used.

Additionally, a P3 program should establish criteria to evaluate whether a particular project is appropriate to pursue on a P3 basis. Such criteria could include an evaluation of the project's public benefits.

For instance, if the project is needed to deliver immediate benefits, the project is a good candidate to proceed as a P3 since P3 projects generally get built quicker due to the fast-track nature of their design and construction.

Another criterion could include an evaluation of the project's technical complexity. If the project is technically complex, where the benefit of the private sector's expertise in design, construction, operation, and maintenance would be better realized, the better suited it is to a P3 approach.

Fairness, Consistency, and Transparency

Equally important, a P3 program should emphasize fairness, consistency, and transparency. Given that some people in the general public have a negative perception of P3s, it is important that the programs con-

sistently adhere to clear evaluation criteria and apply them fairly. Further, the evaluation should be open to public review to ward off concerns of cronyism and the like, and to generate public support for P3s.



A P3 program should also include objectives to be achieved in any P3 agreement. The overall goal of the agreements is to craft them to the strengths of the public and private sectors while respecting the fiduciary duties owed by public officials to their rate-payers and respecting the return on investment that drives

the deals for private partners.

This is accomplished through specific objectives. First and foremost is the clear definition of the technical aspects and the performance requirements for the project

in the P3 agreement. It is best to state these as performance specifications that allow the private partner to determine how best to achieve those requirements. The private partner is in a better position to analyze various design and construction options that are able to create post-construction synergies with operation and maintenance of the completed project.

Allocating Risk

Other objectives to be achieved in P3 agreements include allocating risks to the party best able to manage them. If certain risks are allocated to a private partner that is not able to control them, the government entity will pay a higher price for the P3 deal than it otherwise would if the risk were retained by the public entity. This is frequently called a "risk premium." For instance, the risk of environmental approvals and permits is best retained by the local

government agency, whereas the risks associated with the design, construction, operation, and maintenance of a P3 project

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are shifted to the private partner.

Another important objective is establishing incentives for the private partner in P3 agreements. A premise supporting the development of projects on a P3 basis is that such projects get built more efficiently than traditionally-delivered projects. The efficiencies that P3s can deliver take the form of lower costs, faster completion, and higher quality design and construction. The private partner should be incentivized in P3 agreements to achieve these efficiencies, and if done correctly, a project's overall lifecycle costs should be reduced by 15 to 30 percent while not sacrificing the facility's performance.

P3 agreements also need to avoid private-sector windfalls by capping the private partner's return. This is frequently done by establishing a rate-setting formula to ensure that the cap is not exceeded, that rate increases to ratepayers are fixed and predictable, and that there is a known revenue stream to the private partner.

Internal Political Support

Finally, a public partner's P3 program must have internal political support. Private partners rightly shy away from the risk of negotiating P3 transactions with public partners that have a history of electoral instability or bureaucratic impasse. Therefore, government agencies need to establish themselves as "can do" agencies, where there is minimal political risk that projects will be derailed after time and money have been invested to put together a P3 deal.

In sum, P3s are a powerful tool that can be used to address, in part, our infrastructure needs. Before this can happen, however, public agencies should develop P3 programs based on "best practices" that capitalize on the benefits that P3s offer. It is important for contractors and others involved in P3 projects to understand these practices, so that they better appreciate the risks and rewards that P3 projects entail. ■

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