

MEMORANDUM

February 2, 2010

TO: Transportation, Infrastructure, Energy & Environment (T&E) Committee

FROM: Kristen Latham, Legislative Analyst
Aron Trombka, Senior Legislative Analyst
Office of Legislative Oversight

SUBJECT: OLO Report 2010-6: An Overview of Public-Private Partnerships in Road, Parking, and Transit Projects

On February 4th, the T&E Committee will hold a worksession on OLO Report 2010-6, which was released by the Council on January 26th. Council President Nancy Floreen requested this study to identify the potential benefits, risks, and challenges associated with public-private partnership agreements for transportation projects in roads, parking, and transit.

The use of public-private partnerships (P3s) in transportation is limited throughout the United States. However, there is growing interest in the implementation of P3s to meet transportation needs in the midst of a difficult economic climate. This OLO study is primarily an informational report on public-private partnerships in road, parking, and transit projects that includes the following:

- Summary of the history and legal framework of public-private partnerships;
- Overview of management structures and financing mechanisms available for public-private partnerships;
- Details on the potential benefits, risks, and challenges associated with public-private partnership agreements; and
- Examples of public-private partnerships in road, parking, and transit projects from various jurisdictions across the country.

For this worksession, OLO recommends a briefing on the report by OLO staff followed by comments from Executive Branch representatives.

The remainder of this memo provides a summary of the report, followed by discussion questions for the Council's consideration when determining whether the use of a public-private partnership is feasible and suitable for a transportation project.

A. REPORT HIGHLIGHTS

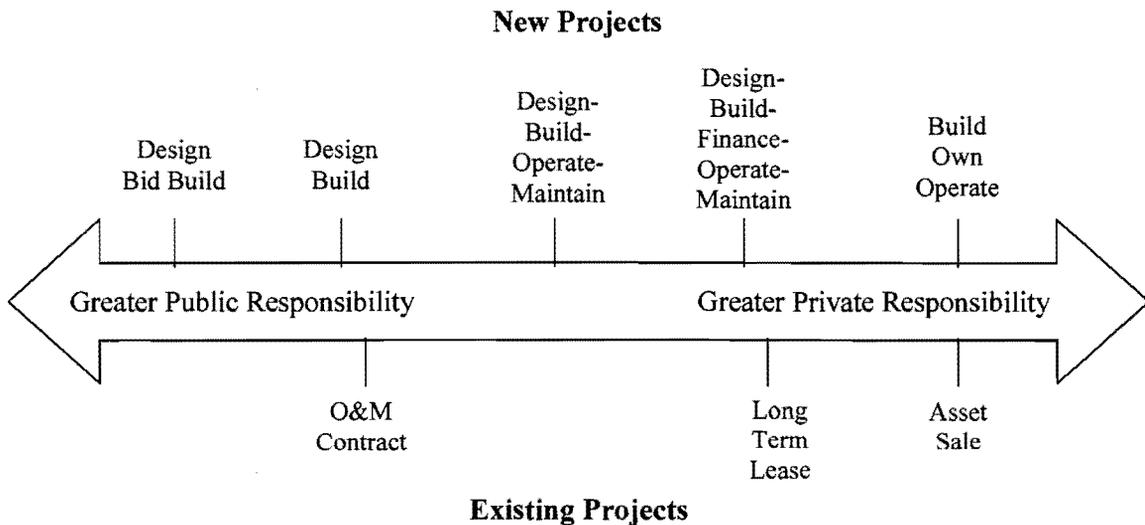
This section summarizes OLO Report 2010-6. The report’s four-page executive summary is attached starting on ©1.

Definition. A public-private partnership (“P3”) is an agreement between a public agency and private sector entity to share responsibility for the development, operation, management, and/or financing of a facility and/or service. The federal Department of Transportation defines a P3 as follows:

A public-private partnership is a contractual agreement formed between public and private sector partners, which allow more private sector participation than is traditional. The agreement usually involves a government agency contracting with a private company to renovate, construct, operate, maintain, and/or manage a facility or system. While the public sector usually retains ownership in the facility or system, the private party will be given additional decision rights in determining how the project or task will be completed.

Types. The diagram on the next page shows the continuum of the types of P3 arrangements used in transportation projects, arrayed from the least to the greatest private sector involvement, followed by a brief description of each approach. A P3 project is often a hybrid of two or more of these methods.

Types of Public-Private Partnership Arrangements¹



¹ Adapted from the National Council for Public-Private Partnerships

The following provides a brief description of each type of public-public private partnership approach identified above:²

Summary of Public-Private Partnership Approaches

Design-Bid-Build	The government contracts with the private sector for the design and construction of a project under separate contracts. The government assumes operational responsibility.
Design-Build	The government contracts with the private sector for the design and construction of a project under one contract. The government assumes operational responsibility.
Operations and Maintenance (O&M) Contract	The public sector contracts with the private sector to perform specific services.
Design-Build-Operate-Maintain	The government contracts the private sector to design, build, operate and maintain a project. Ownership and operating revenue is retained by the public sector.
Design-Build-Finance-Operate-Maintain	The government contracts the private sector to finance, design, build and operate a project. Ownership is retained by the public sector but the private sector receives revenues generated during the project’s operation.
Long-Term Lease	The public sector leases a publicly financed facility to the private sector for specified time.
Build-Own-Operate	The private sector finances, designs, builds, and operates a project. Ownership is retained by the private sector.
Asset Sale	The public sector sells ownership of a public facility to the private sector.

Legal Framework. The federal government has passed three transportation laws that support and promote the use of P3s including the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), Transportation Equity Act for the 21st Century 1998 (TEA-21), and the Safe, Accountable, Flexible, Efficient Transportation Equity Act 2005 (SAFETEA-LU). In addition, the following federally-funded programs also promote the use of P3s in transportation:

- Special Experimental Project – 14 (SEP-14) supports states in evaluating non-traditional contracting techniques.
- Special Experimental Project – 15 (SEP-15) identifies public-private partnership approaches that advance the efficiency of transportation projects.
- New Starts Program is the primary funding resource for supporting locally planned and operated transit capital investments, including P3s.
- Public-Private Partnership Pilot Program (Penta-P) encourages more private sector involvement in transportation projects by evaluating the benefits of forming P3s for federally-funded projects.

Maryland is among 25 states that have adopted some type of enabling legislation for public-private partnerships in transportation ranging from broad authorization for all types of projects to limited authorization of specific projects.

² Definitions adapted from National Cooperative Highway Research Program (2009), based on FHWA’s “User Guidebook on Implementing Public-Private Partnerships for Transportation Infrastructure Projects in the United States.”

Financing. Many of the following financing tools are available for traditional procurement of transportation projects or services; however, many of these tools promote the use of P3 as a funding alternative. Often, transportation projects are funded using a combination of funding sources and financing approaches.

Financing Mechanisms for Transportation Projects

Mechanism	Brief Description
Federal Credit Assistance	
Transportation Infrastructure Finance and Innovation Act (TIFIA) Program	The program provides three forms of credit assistance to public and private sector – secured (direct) loans, loan guarantees, and standby lines of credit to eligible transportation projects.
State Infrastructure Bank Program (SIB)	Revolving loan program to provide infrastructure investment funds such as loans at subsidized rates and/or with flexible repayment provisions; grant anticipation notes (GANs); and short-term construction or long-term debt financing.
Section 129 Loans	Loan program that allows federal participation in a state loan to support projects with dedicated a revenue stream.
Bonding and Debt Instruments	
General Obligation Bonds	Municipal bonds issued that are backed by the "full-faith-and-credit" of the issuer.
Limited and Special Tax Bonds	Bonds issued on the pledge of the proceeds against a specific tax.
Revenue Bonds	Bonds issued in which revenues are used to make payments including toll-backed bonds and fare box revenue bonds.
Private Activity Bonds (PABs)	Bonds issued by or on behalf of local or state government for the purpose of financing the projects of the private sector.
Tax Credit Bonds	Bond in which bondholders receive federal tax credits of up to 100 percent of the interest amount in lieu of or in addition to partial interest payment.
Nonprofit Financing	Incorporation of the public-private partnership as a nonprofit corporation to allow the project to be financed with tax-exempt bonds.
Anticipation Notes	Short-term notes issued based on the anticipation of funding from a specific source.
Other Financial Mechanisms	
Flexible Match	Program that allows a variety of public and private contributions to be counted toward the non-federal funding matching requirement of federal-aid projects.
Pass-through Tolls	Per-vehicle or per-vehicle-mile fees paid by the public sector to the private sector as reimbursement.
Availability Payments	Payments made to the private sector partner by the public sector based on project milestones or facility performance standards.

Benefits and Risks/Challenges. The involvement of the private sector in the development of transportation projects may improve project feasibility and cost-effectiveness in addition to providing alternative financing options and operational flexibility. Some of the most frequently cited potential benefits of P3s are:

- A Quick Influx of Cash;
- Lower Costs;
- Access to Non-Traditional Funding;
- Transferring and Sharing of Risk;
- Increased Mobility on Roads; and
- Improved Quality.

However, the shift of financial and operational risk to the private sector under a public-private partnership may result in the public getting less value compared to more traditional public financing and reduced flexibility for the government. Some of the most frequently cited risks and challenges of P3s for transportation projects include:

- Difficulty in Estimating Worth;
- Additional Costs to the Public Sector;
- Higher Cost of Private Financing;
- Financial Difficulties by the Private Sector Partner;
- Higher User Rates for Transportation; and
- Loss of Policy Control.

Case Studies. The use of public-private partnerships remains limited throughout the country. The use of P3s in road construction and management is the most prevalent form of transportation P3s while the use of P3s in transit and parking are less common.

For this report, OLO summarized the following ten case studies of road, parking and transit P3 agreements. For each, the private sector had significant control over management and financing of the project.

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| • Lease of the Chicago Skyway | • Lease of Chicago Parking Garages |
| • Lease of the Indiana Toll Road | • Lease of Chicago Parking Meter System |
| • Construction of the Dulles Greenway | • Proposed Harrisburg Parking Lot Lease |
| • Construction of the Pocahontas Parkway | • Construction of Hudson-Bergen Light Rail |
| • Proposed Lease of the PA Turnpike | • Construction of Las Vegas Monorail |

B. RECOMMENDED DISCUSSION ISSUES

Not all transportation projects are suitable or feasible for P3 agreements. Each local/state government must determine the feasibility of a P3 in the midst of competing policy objectives. The following provides a series of recommended steps for public sector decision makers to take when considering whether a P3 agreement is the best approach for delivery of a transportation project; and if so, how it should be structured.

Step 1: Identify project goals and funding availability. Examine the transportation, economic development, and environmental goals of the project; and determine the amount of public funding available for a project. Decision makers should analyze all of the potential goals of the project including:

- Relief of traffic congestion;
- Improvement of accessibility;
- Stimulation of economic development;
- Achievement of land use objectives;
- Protection of the environment; and/or
- Creation/preservation of jobs.

Step 2: Evaluate whether the project is suitable for a public-private partnership. Assess whether a project is a candidate for a P3, which includes determining: whether the authority exists to enter into a P3 agreement; whether the government has the capacity to provide sufficient oversight or financial support, and whether the private sector has the resources, expertise, and incentives to enter into a partnership. Some questions to be considered include:

- Does the jurisdiction have the authority to enter into a P3 arrangement?
- Does the private sector have the resources and expertise to manage the project better than the public sector?
- Would the private sector have an opportunity to achieve a reasonable return on investment from the project?
- How much will users be willing to pay?
- To what degree, if any, would the public sector subsidize the construction, operations, or maintenance of the project?
- Does the public sector have the capability to oversee the private management of the project?

Step 3: Identify safeguards needed to protect the public interest. Protect the public's interest by: ensuring proper valuation of the project; implementing performance standards and measures; assessing the impact on other policies; and providing adequate oversight. Some questions to be considered include:

- How will the government determine the value of the P3 contract or lease?
- What performance standards and measures will be required?
- Should the contract limit rate increases?
- Should the contract include provisions to help achieve other public policies?
- How will the government oversee implementation of the agreement?
- What would happen in the case of default?

Step 4. Select suitable financial mechanisms for the public-private partnership. Examine the financial aspects of the P3 agreement including all financial assumptions used, available financing options, other costs and financial risks associated with the partnership, and the use of revenue. Some questions to be considered include:

- How were the financial assumptions built? Are they reasonable?
- What are the current options for financing? What are the benefits and drawbacks of each option?
- What are the transaction/other costs associated with the deal, and does the public sector have the financial capacity to cover these costs?
- What financial risks do the public and private sectors bear in the deal? Does the structure of the agreement account for risks?
- How should the revenue from the P3 be spent? If there is an upfront payment, will the revenue be used to create a sustainable source of revenue for the future?

Step 5: Develop a process to ensure transparency. Ensure that all information on the P3 is publicly available. In addition, provide an opportunity for public feedback on the partnership, both during the selection process and after implementation.

- How will the government receive public input?
- Will the bidding process be fully competitive?
- Will decision-makers have access to the information they need to make a sound decision?

LIST OF ATTACHMENTS

Item	Begins at:
OLO Report 2010-6 Executive Summary	©1

AN OVERVIEW OF PUBLIC-PRIVATE PARTNERSHIPS IN ROAD, PARKING, AND TRANSIT PROJECTS
OFFICE OF LEGISLATIVE OVERSIGHT REPORT 2010-6
JANUARY 26, 2010

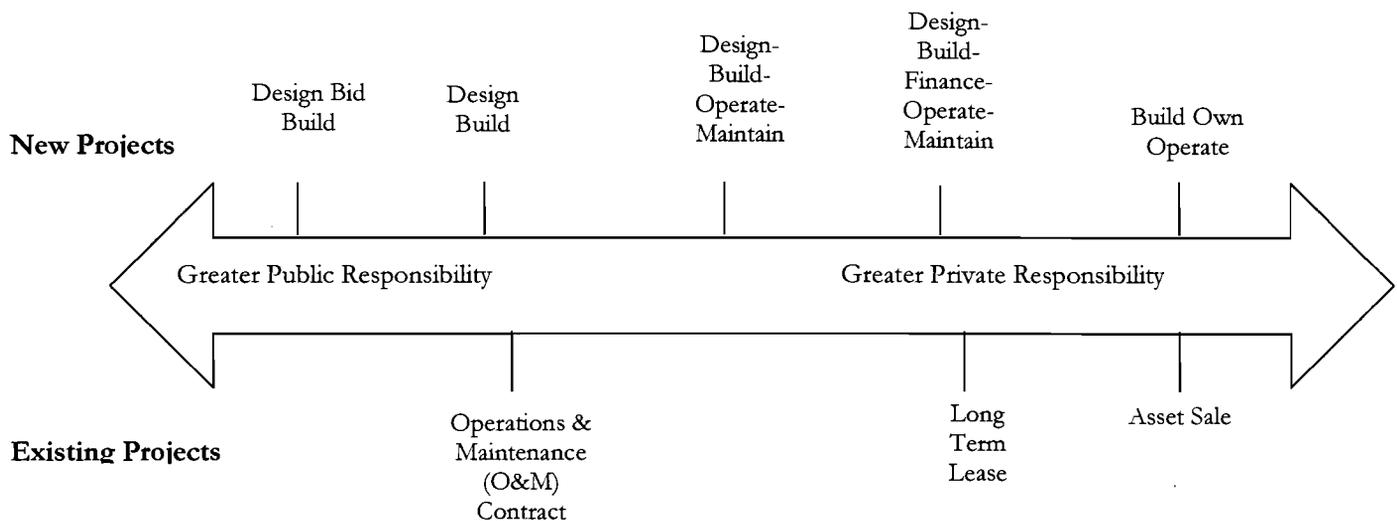
State and local governments face a widening gap between increasing transportation system costs and declining public funds. There is growing interest in exploring alternative approaches to finance and operate public assets, including public-private partnerships. This report by the Office of Legislative Oversight (OLO) responds to the Council's request to identify the benefits, risks, and challenges associated with public-private partnership agreements for transportation projects in roads, parking, and transit.

Overview

The general accepted definition of a public-private partnership (P3) is a contractual agreement between public and private sector partners where a government agency contracts with a private entity to construct, operate, finance, maintain, and/or manage a facility or system. While the public sector usually retains project ownership, the private sector is given additional decision rights as to how the certain tasks are completed or how the project is operated.

P3 arrangements span a continuum of public/private responsibility. The diagram below depicts several P3 arrangements, with increasing levels of private sector responsibility from left to right. The approaches range from more traditional procurements such as *Design Bid Build* and *Operations and Maintenance (O&M) Contracts* to full privatization of a project such as *Build Own Operate* and *Asset Sale*. It is not unusual for a P3 agreement to reflect a combination of two or more of these methods. For a more detailed definition of each public-private partnership arrangement identified, see Chapter II (page 5).

Continuum of Public-Private Partnership Arrangements



Public-Private Partnerships in the United States. Recently, more interest exists in P3s for transportation projects because: (1) the transportation infrastructure is aging; (2) competition for limited public financing is increasing; and (3) the appeal among public sector decision makers is growing.

Although numerous examples of public-private partnership projects exist worldwide, the number of operational U.S. transportation partnership projects is relatively limited. Nationally as of 2008, there are only 15 private roads and a handful of transit and parking projects in operation.

Legal Framework

The Federal government promotes the establishment of public-private partnership transportation projects with numerous laws and programs. Through these measures, the Federal government has:

- Identified the private sector as a source for funding transportation improvements;
- Increased funding flexibility and relaxed funding restrictions for toll roads;
- Allowed the private sector to own toll facilities;
- Established credit assistance programs for private sector sponsors; and
- Encouraged the use of innovative financing methods.

To further encourage P3s, 25 states (including Maryland) have adopted some form of enabling legislation for transportation-related public-private partnerships. Some of these laws only authorize individual projects whereas others broadly authorize all types of P3s.

The Code of Maryland Regulations authorizes the State to enter into P3 agreements with private entities. While the Code does not expressly authorize use of P3s for highways, the Maryland Attorney General has ruled that the law does not prohibit “a private entity from owning, constructing, operating, or maintaining a highway.” The General Assembly also established the Transportation Public-Private Partnership Program to encourage the private sector’s involvement in the acquisition, financing, construction, and operation of new and existing transportation facilities. The program primarily targets transit-oriented development projects.

Financing

Historically, state and local governments financed transportation infrastructure with a combination of state and local taxes and federal grants from the Federal Highway Trust Fund (funded by a federal gasoline tax). In recent years, governments have looked into “innovative finance mechanisms” – defined as alternatives or supplements to traditional, tax- or grant-based funding strategies – to fund transportation projects. The primary types of financing used in public-private partnership development are summarized below.

Federal Credit Assistance. To expedite the development of state and local transportation projects, the federal government has created a financial market that gives private entities access to credit, as a loan or a federal subsidy. Specific federal programs to finance P3 projects through credit assistance include: the Transportation Infrastructure Finance and Innovation Act (TIFIA) Program; the State Infrastructure Bank Program (SIB); and Section 129 Loans.

Bonding and Debt Instruments. Traditionally, the transportation bonds used to finance local highways and transit systems were municipal bonds, backed by the taxing authority of the state or local government. More recently, to access increased bond funding capacity, these governments have issued bonds backed by funding sources not previously used to secure debt. Examples of these approaches include: limited and special tax bonds; revenue bonds; private activity bonds; tax credit bonds; and anticipation notes.

Other Mechanisms. Some examples of other financial tools that state and local governments have used to structure the private financing and/or ownership of transportation projects include: flexible match, pass-through tolls, and availability payments (payments based on project milestones or performance standards).

For more explanation of the financial mechanisms identified, see Chapter II (on page 12).

Benefits, Risks and Challenges

Benefits. The involvement of the private sector in the development of transportation projects can provide additional financing options and operational flexibility to achieve a project's objectives. Some frequently cited benefits of P3s are:

- A Quick Influx of Cash. Contracts often stipulate a large upfront payment that local officials can use to close budget gaps or free up resources for other needs.
- Lower Project Costs. Agreements can lead to cost efficiencies based on assumptions about lower direct costs (e.g., cost saving construction methods), lower indirect costs (e.g., lower overhead expenses), and lower life-cycle costs (e.g., from minimizing long-term costs).
- Access to Non-Traditional Funding. Partnerships can include the use of private equity and federal and state financing options/programs, which promote P3s such as non-traditional bonding authority, federal credit assistance, and state infrastructure banks.
- Transferring and Sharing of Risk. Partnership arrangements may require a private firm to assume design, construction, financing, operations, and maintenance risks. If a private firm has more capacity to manage or diversify these risks, then public responsibility for these risks can be lowered.
- Increased Mobility on Roads. Because private partners are not directly accountable to the taxpaying public, a private company may have more flexibility to use financing techniques such as congestion pricing to reduce traffic congestion.
- Improved Quality. P3 arrangements can provide the flexibility to maximize the use of innovative technology and the ability to select the best materials in order to improve the quality of a project.

Risks and Challenges. Shifting financial and operational project risks to a private firm under a public-private partnership may result in the public getting less value or paying more compared to more traditional public financing. A P3 arrangement can also limit a local government's ability to make operational project changes or changes that would further other public policies. Some frequently cited risks and challenges of P3s for transportation projects include:

- Difficulty in Estimating Value. Determining the long-term value of a transportation project can be a complex and imprecise activity. An agreement that incorporates a forecast that underestimates a project's long term value can lock in a long-term public loss.
- Additional Costs to the Public Sector. P3s can result in extra costs to the public sector such as costs to review, select, and monitor the partnership; and the potential foregone tax revenue when tax-exempt debt is issued.
- Higher Cost of Private Financing. Generally, the borrowing costs of private debt are higher than public tax-exempt debt. This cost difference can result in these higher costs being passed through to the public in the forms of a lower up-front payment or higher user rates.
- Financial Difficulties by the Private Sector Partner. If a private sector partner can no longer finance the operations and defaults on the partnership agreement, the public partner may have to step in and identify funds to finance the operating costs.
- Higher User Rates for Transportation. Because the private sector will seek a return on its investment, toll or fare rates may be higher than they would have been with public financing.
- Loss of Policy Control. Government policies in all policy areas are interconnected; therefore a P3 agreement may have a long-term impact on future policy, particularly transportation, economic, or environmental policies.

Case Studies

For this report, OLO reviewed ten case studies of road, parking and transit P3 agreements. In each case, the private sector had significant control over management and financing of the project.

- Lease of the Chicago Skyway
- Lease of the Indiana Toll Road
- Construction of the Dulles Greenway
- Construction of the Pocahontas Parkway
- Proposed Lease of the PA Turnpike
- Lease of Chicago Parking Garages
- Lease of Chicago Parking Meter System
- Proposed Harrisburg Parking Lot Lease
- Construction of Hudson-Bergen Light Rail
- Construction of Las Vegas Monorail

Overall, OLO found these P3 projects produced mixed results. Among the successes:

- Chicago received a large amount of revenue that it used to fund other immediate needs of the City.
- The Dulles Greenway was finished ahead of schedule and on budget.
- Almost all of the projects were funded primarily through innovative financing mechanisms, including some projects which were funded with no public dollars.

Many P3 arrangements encountered problems. Among the challenges these P3 projects faced:

- Many of the selected projects did not meet their projected revenue and traffic forecasts.
- A lack of public support led to the rejection of the PA Turnpike and Harrisburg Parking leases.
- All of the selected projects have increased user rates since implementation.
- The Las Vegas Monorail revenues are not sufficient to covering the facility's debt payments.
- According to an Inspector General report, the City of Chicago received \$974 million less than the long-term value of the parking meters in its P3 lease agreement.

Recommended Steps for Considering a Public-Private Partnership

Not all transportation projects are suitable or feasible for P3 agreements. In the midst of competing policy objectives, local/state government officials must first assess the feasibility of each P3 project proposal, and then carefully structure an agreement. The checklist below recommends steps for public decision makers to follow when they are considering whether a P3 is the best approach for delivery of a transportation project; and if so, how an agreement should be structured.

- Step 1: Identify project goals and funding availability.** Examine the transportation, economic development, and environmental goals of the project; determine the public funding available for a project; and identify the specific core public policies to be furthered by a P3 approach.
- Step 2: Evaluate whether the project is suitable for a public-private partnership.** Assess whether a project is a candidate for a P3 agreement by determining: whether the authority exists to enter into a P3 agreement; whether the government has the capacity to provide sufficient oversight or financial support, and whether the proposed private sector partners have the technical resources, management expertise, and financial capacity to enter into a partnership.
- Step 3: Identify safeguards needed to protect the public interest.** Protect the public interest by: ensuring proper project valuation; implementing project performance standards, measures and milestones; assessing how the project impacts other policies; and funding competent oversight.
- Step 4. Select suitable financial mechanisms for the public-private partnership.** Examine all financial aspects of the P3 agreement such as revenue forecasts, available financing options, direct and indirect project costs, assignment of financial risks, and use of revenue.
- Step 5: Develop a process to ensure transparency.** Ensure that detailed information about the P3 project and agreement is understandable and publicly available. Provide opportunities for public feedback, both during the selection process and after project implementation.

Determining the appropriate sharing of responsibilities, risks, and rewards in a P3 poses both a challenge and opportunity for the public sector seeking to improve their transportation system.