Public-Private Partnerships – Building Roads to the Future

The Department of Finance estimates that California is in need of $500 billion worth of infrastructure in the next two decades. In the face of limited financial resources to pay for construction of new facilities and renovation of existing ones, the debate in California over the desirability of public-private partnerships (commonly referred to as a PPP or P3) is at an all time high. There is nothing new with the involvement of the private sector in the delivery of public services. PPPs in the form of build, operate and transfer were used as early as 1858 for the construction of the Suez Canal. However, in California, PPPs, in relative terms, are the new kids on the procurement block. One of the most immediate issues is building confidence in the process.

Background

A PPP is a contract formed between a public agency and a private sector entity that delivers vital transportation, education, health, and other infrastructure projects to its constituents where the resources – both monetary and political – do not allow a purely publicly financed project to proceed. Traditionally, the private sector participation has been limited to separate planning, design or construction contracts on a fee for service basis, based on the public agency's specifications. Expanding the private sector role allows the public agencies to draw upon the advantages of the private sector such as access to capital, skilled management resources, knowledge of innovative technologies, and entrepreneurial spirit.

Performance-based payments increase incentive to deliver long term efficiency and reliability. The private partner can increase its business opportunities in return for assuming the new or expanded responsibilities and risks. In some types of PPPs, the government uses tax revenue to provide capital for investment, with operations run jointly with the private sector or under contract. In other types, capital investment is made by the private sector on the strength of a contract with the government to provide agreed services. Government contributions to a PPP may also be in kind such as the transfer of existing assets.

Typically, a private sector consortium forms a special company called a "special purpose vehicle" (SPV) to build and maintain the facility. The consortium is usually made up of a building contractor, a maintenance company, and a bank lender. It is the SPV that signs the contract with the public agency and with subcontractors to build the facility and then maintain it. All PPP procurement results in a large proportion of risk being transferred to the private sector. Certain PPPs involve limited risk transfers such as design-build contracts with the public agency remaining responsible for the finance, operation, and maintenance of the project, but the private contractor assumes the design and construction risk. At one level, PPPs are a method of outsourcing the delivery of public services in which the government assumes the role of purchaser of these services from the private sector supplier.

Legislation

Governor Schwarzenegger has launched a major PPP initiative his office has termed Performance Base Infrastructure (PBI). Governor Schwarzenegger intends to fund some of the State's needed infrastructure, such as the proposed California High Speed Rail *(see companion newsletter article)*, roads, courthouses and correctional facilities, through PBI delivery. California has ample legal authority permitting the use of PPPs for public projects. California has recently enacted PPP legislation where the entity assumes a greater role in the planning, finance, design, construction, operation, and maintenance of the public infrastructure project, as compared to a traditional procurement contract.

In the transportation sector, Assembly Bill 1467 enacted by the Governor and Chaptered by the Secretary of State in May 2006 added Sections 143 and 149.7 to the California Streets and Highways Code. The bill authorized Caltrans and Regional Transportation Agencies (RTAs) to enter into comprehensive development lease agreements with public and private entities, or consortia of those entities, for certain transportation projects. RTAs are defined as transportation planning agencies, county transportation commissions, any other local or regional transportation agency designated by statute as a regional transportation agency, and a joint exercise of powers authority (with the consent of transportation planning agency or a county transportation commission). Authorized transportation projects are highway, public street, rail or related facilities supplemental to existing facilities currently owned and operated by Caltrans or RTAs.

The pilot program was limited to two projects in Northern California and two in Southern California until January 1, 2012. On February 15, 2009, Senate Bill 4 was passed which amended Section 143 of the California Streets and Highways Code relating to public contracts. This new law would extend the authorization for these agreements to January 1, 2017, and would delete the restriction on the number of projects that may be undertaken. The bill eliminates the requirement that the negotiated lease agreements be approved or rejected by the Legislature. Instead, the new law requires that all lease agreements first be submitted to the California Transportation Commission (CTC) for approval, then to the Legislature and the Public Infrastructure Advisory Commission (PIAC).

The PIAC is an auxiliary organization established by the Business, Transportation and Housing Agency (BT&H) that will serve as advisor to Caltrans and RTAs in developing transportation projects through performance-based infrastructure partnerships. The PIAC is authorized to: (a) identify candidate PPP projects throughout California; (b) research PPP best practices and lessons learned; (c) assemble information related to PPPs that Caltrans/RTAs can utilize; and (d) review and comment on final lease agreements. Projects that PIAC identifies as potential PPPs will be submitted to Caltrans/RTA for screening.

Ultimately, Caltrans/RTA decides which proposed projects and associated lease agreements are to be submitted to the CTC. The CTC at regularly scheduled public hearings will select the candidate projects from nominated projects. The projects authorized shall be primarily designed to achieve the following objectives: (a) improved mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor; (b) improve the operation or safety of the affected corridor; (c) provide quantifiable air quality benefits in the region; and (d) address a known forecast demand. The CTC is also charged with developing evaluation criteria for “best value” proposals.

Procurement Process

In selecting private entities with which to enter into these agreements, Caltrans/RTA is afforded flexibility and may utilize, but are not limited to utilizing, one or more of the following procurement approaches: (a) solicitations of proposals for defined projects and calls for project proposals within defined parameters; (b) prequalification and short-listing of proposers prior to final evaluation of proposals; (c) final evaluation of proposals based on qualifications and best value; (d) negotiations with proposers prior to award; and (e) acceptance of unsolicited proposals, with issuance of request for competing proposals.

Neither Caltrans nor the RTA may award a contract to an unsolicited bidder without receiving at least one other responsible bid. When evaluating a submitted proposal, Caltrans/RTA may award a contract on the basis of the lowest bid or “best value”. Caltrans/RTAs must hold at least one public hearing at a location near the proposed facility for purposes of receiving public comment on the lease agreement.

At least sixty days prior to executing the lease agreement, Caltrans/RTAs must submit the draft lease and any comments from the public hearing to the Legislature and PIAC for review. The Legislature or the Secretary of the BT&H may provide written comments to Caltrans/RTAs within this sixty-day period. Caltrans/RTAs shall consider those comments prior to executing the lease. No approval is required from the Legislature or PIAC to execute the lease. Finally, the lease agreement must include indemnity, defense, and hold harmless provisions protecting the State of California or the RTA against any claims or losses resulting or accruing from the performance of the contracting entity or lessee.

Failure to comply with the lease agreement in any significant matters shall constitute a default under the agreement and Caltrans/RTA shall have the option to initiate processes to revert the facility to the public agency. Further, the lease agreement shall require the contracting entity or lessee to provide any information or data requested by the CTC or the Legislative Analyst. The CTC, in cooperation with the Legislative Analyst, shall annually prepare a report on the progress of each project and ultimately on the operation of the resulting facility. All lease agreements must be signed no later than December 31, 2016.

Caltrans shall remain responsible for predevelopment services for projects on the State Highway System and preparation of plans and specifications for each transportation project on the State Highway System. This work may be performed by either Caltrans employees or assigned to consultants. Caltrans standards apply for State Highway Facilities.

Project Ownership

At all times, the project is owned by Caltrans or the RTA. Agreements may grant to the private party a lease of right-of-way and airspace. All granted interests revert back to Caltrans/RTA at the end of the term. At the reversion, the private entity must deliver the project in a condition that meets Caltrans/RTAs performance and maintenance standards.

Tolling

The statute authorizes tolling, including after the expiration of the term. Lease agreements for tolled projects must establish specific toll or user fee rates. Increases not established or identified in the agreement are subject to Caltrans/RTA approval after a public hearing. Tolls must be applied to project capital outlay costs, operating costs, toll collection costs, maintenance, police services, debt service, and reasonable return on investment. Any tolls remaining go to the State Highway Account (for Caltrans projects) or to the RTA for “improving public transportation in or near the project boundaries.”

While there exists the enabling legislation to pursue transportation projects though PPPs, the keys to sustaining this delivery system are a collaborative working relationship and an acceptable allocation of financial risks and rewards.

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