Public-Private Partnerships: THE NEW BREED

Creative government leaders are realizing that blending capabilities, resources and risk with the private sector is a viable way of providing essential services and improving operations.

As state and local governments face challenges to operate more efficiently and cost-effectively, public-private partnerships (PPPs) are a promising tool to enhance essential public services, operations and facilities – without having to increase taxes.

PPPs, also known as P3s, have existed for centuries. In 1652, the Water Works Company of Boston was the first private firm in America to provide drinking water to citizens, according to the National Council for Public Private Partnerships (NCPPP).

"We're just now catching up with the rest of the world," says Richard Norment, NCPPP executive director. He explains that state and local governments in the past may have been hesitant to form partnerships with the private sector after hearing stories about bad deals. "Money was pretty fast and loose prior to 2008; a lot of investments were made prior to that where they didn't do the proper due diligence on contracts." Consequently, "in the past four to five years, private sector investors are conducting closer analyses on 'Why would we want to invest in this project the way it's structured?' Projects also are providing better quality control measures to help both the public and private sector make sure they're getting into sound deals in terms of how effective PPPs are and how well they perform."

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Say, for example, a municipality wanted to partner with the private sector to build a toll road, Norment says. "Before 2008, you'd get some money to build it and never check anything. Now, after 2009, an investor comes in and says, 'You have to put enough toll booths in this area, you need to add more toll booths here to get traffic to flow more effectively.' … The private sector says, 'We can maintain this much more efficiently, we can improve traffic flow and we'll give you money upfront, but we will recoup our investment over 20 years from the tolls.' … Now, the due diligence is to the benefit of both sides of the partnership."

PPP Drivers

Certainly, better contracts — and subsequently more successful partnerships and outcomes — are leading state and local governments to leverage the combined resources of the public and private sectors to improve the quality of services. Aging infrastructure and shrinking budgets also are major drivers of the upswing in PPP growth, experts say.

Norment cites an American Society of Civil Engineers (ASCE) report that says in virtually every area of public life from highways to waterworks, "We've done a horrible job throughout the country of maintaining systems." For instance, he says Washington, D.C.'s water system is more than 100 years old and has had relatively little maintenance throughout its lifespan. The ASCE report also indicates that 75 percent of America's school buildings are inadequate to meet student needs and "to close this schoolhouse gap would require a capital investment of $3,800 for every student in the United States."

"All levels of government have tighter budgets and have to make careful decisions as to where they spend money. Frequently, maintenance and new construction are further down on the to-do list," Norment says. As a result, he says, state and local governments realize that the combined capital and intellectual resources of the public and private sectors can result in better facilities and more efficient services without having to increase taxes.

As governments seek out PPPs, lawmakers are simultaneously exploring new legislation to facilitate such partnerships. A new development under Section 331 of the 2013 National Defense Authorization Act allows local governments to partner directly with the federal government on installation support services without going through the normal acquisition process, according to David Zelenok, chief innovation officer for Centennial, Colo. Monterey, Calif., is the best example of this, he says, in that it partnered with the federally-owned Presidio of Monterey to provide facility maintenance, including buildings, roads, the sewer and electrical system, and heating and air conditioning. "This is a trend that's going to see some momentum where local governments will partner with the federal and private sector; Monterey may bring in a private contractor to work on the federal government's behalf on a local government contract," he says.

"Radical, new legislation is allowing PPPs to be used at the city and county level and bringing into clear focus what their capabilities can be," Norment says.

He says PPPs are such sound investments that a couple of companies have sprung up to help pension funds find viable PPPs in which to invest. The California Public Employees' Retirement System (CalPERS), for example, is investing more than $1 billion in PPPs. "When choosing investments the

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question is, 'Do we want to put it in the stock market or treasury bills and get nothing in return for it?' PPPs are a stable investment," he says.

Building Successful Partnerships

According to Zelenok, PPPs provide the best value for the money when:

- The public sector and governing body support the project;
- The public sector has conducted proper analysis on the project to understand the present and future lifecycle costs of a project before sending out requests for proposals/bidders;
- There is a detailed contract that describes the responsibilities, risks and benefits for both partners;
- There is a clearly defined revenue stream; and
- Both parties share in the project's risks and rewards.

"Not every city can adopt a partnership. In some cases, there may not be a robust private sector that can offer services, and a PPP may not be financially worthwhile or feasible," Zelenok says. He notes that union restrictions sometimes prohibit local governments from converting a city function to the private sector. So, state and local governments need to examine a project to demonstrate whether there are operational and financial advantages to bringing services in-house or transferring operations to the private sector. The analysis should allow the public sector to determine exactly what all of the costs would be throughout the life of the project, if it managed the project itself.

If a local government is trying to maintain a wastewater system, it needs to know when the pumps will wear out, as well as factor in full lifecycle costs over the next 10, 20, 30 years to include employee wages, pension, health benefits and percentage of administrative staff to support the operations, Zelenok says. Typically, a government can manage services cheaper because it does not have to pay taxes or insurance, assuming it is self-insured. However, you have to add in those "hidden and legacy costs, of not only paying for the services and employee salaries today, but also some pension benefits into the long-term future," he says.

Norment says once the public sector determines the cost to operate, build and maintain the system, it is ready to issue RFPs, because then the municipality has data to make public versus private sector cost comparisons.

PPPs can often yield a 17 percent to 47 percent savings on the cost of what it would take the local or state government to provide the service, Norment says. Additionally, the private sector often has refined the newest and best techniques and technologies it can use to boost savings and to benefit the public.

The Missouri Department of Transportation, for example, created a PPP to maintain a 20-mile stretch of road for 25 years, bring 800 of its lowest-rated bridges up to satisfactory condition and avoid the estimated $600 million to $800 million capital cost of repairs. Although the roadways did not generate much revenue, the state dedicated federal bridge replacement funds to pay its private partner. Moreover, the private sector completed the job for no more than what the state would have paid because it used new types of asphalt that created additional savings, Norment says.

Even when turning a project over to the private sector to operate or manage does not create huge savings, that does not mean the local government should avoid PPPs. "You have to understand why the [private sector] bid is higher [than the public sector cost] and which risks are being transferred," Norment says.

"If someone is injured in a dump truck, or a pedestrian is injured because of a city operation, there is a risk to the city for the actions the government is doing," Zelenok explains. "If the private sector is handling the operations, then the city has virtually no risk." That's why even when a private company's bid is equal to the public sector cost, Centennial's city council leadership prefers to award the contract to the private sector; it is able to transfer risk to the private sector.

In fact, "A tenet in Centennial is the city council, as a policy, wants to explore every opportunity to partner with the private sector before looking internally to run the city," Zelenok says. "We first look to the outside, and if we can demonstrate there is a financial advantage to bringing services in-house, we'll bring them in-house."

Take, for example, the city's snowplowing. The city initially projected it would cost $9.9 million over five years to plow its own streets. However, it created a PPP, in which private sector companies bid $9.8 million to $9.9 million to manage 60, 12-hour shifts during snow season to plow about 600 miles of snowstorm. Zelenok says although the costs were virtually the same when comparing public versus private figures, the private partner brought additional value to the relationship by giving the city 93 extra miles of free snowplowing by developing more efficient routes with global positioning systems. By using technology it had worked with in the waste industry, the private contractor made "loops and turnarounds in unexpected places," and is able to provide 93 extra miles of snowplowing for the same cost, he says.

To protect the public in the snowplowing partnership, Centennial wrote into the contract that it would purchase all of the de-icing chemicals and fuel. That way, the city has ensured that no matter how bad the weather gets, there are no financial incentives for the contractor to try to cut costs and skimp on putting down the correct amount of de-icing chemicals.

The snowplowing example, Zelenok says, shows that successful PPPs can allow the public and private sector parties to share risks and rewards. The city knows this from experience. It is the largest city in the nation to have outsourced all of its public works to the private sector, and because of its PPPs, it is able to manage the city with only about 40 employees. Furthermore, Centennial believes it might be able to improve public services and reduce costs by exploring emerging PPP opportunities in managing things like streetlights, traffic signals and in providing broadband service.

Norment recalls PPPs previously were restricted to transportation projects, but governments increasingly are creating partnerships for water resources, public hospitals and more. "It's interesting to see how PPPs keep evolving, morphing and getting better," he says. "If you need a new water system, hospital or dormitory on a college campus, and the public sector doesn't have funds for the project, PPPs are a way to provide the private sector with a reasonable return while answering the public sector's needs." ■