It is no secret that infrastructure in the U.S. needs a substantial amount of investment to modernize and remain competitive. However, funding for major infrastructure projects can be hard to find for cash-strapped local governments. One possible solution that has emerged is the “public-private partnership” (or P3). Under these arrangements, a private entity, usually an infrastructure fund or a consortium of investors (often made up of an infrastructure fund and a major building contractor) invests in the infrastructure project and in some circumstances, keeps all or part of the revenue stream. While government officials were initially reluctant to embrace these arrangements, they have been gaining acceptance. For example, in July, President Obama announced a new program to attract more private money to help finance new roads, bridges, and highways and last year Maryland’s legislature passed a bill to allow for a private entity to design, build, finance, and maintain its new $2.2 billion light rail system. Attracted to the steady income streams produced by these projects, investors have committed about $263 billion to infrastructure funds since 2006.

Governments benefit by transferring much of the risk associated with large infrastructure projects, while still maintaining control of project specifications, operating standards and regulatory requirements and procedures. They also usually maintain ownership of the underlying assets. Investors gain access to a consistent revenue stream that usually tops ten percent annually.

As interest in P3s has increased, their use has already begun to expand beyond roads and bridges to such “social infrastructure” projects as university facilities, courthouses, and schools. For example, KPMG advised the infrastructure fund, Meridiam Infrastructure, on its investment and construction of the Governor George Deukmejian Courthouse in Long Beach, California, the first P3 used for social infrastructure in the U.S.

While these types of arrangements seem like win-win situations for cash-strapped governments, as well as investors, there are many issues that require careful diligence before proceeding.

**Evaluating the benefits of a P3**

In order to determine the appropriateness of a public-private partnership, public officials need to consider several issues. First, the project needs to be evaluated on its own merits and should meet the government’s strategic and policy objectives. Projects that don’t make sense should not be pursued just because financing is available.

Next, government officials should determine if they have authority to enter into a P3 project. If the authority does not exist, officials need to decide if the current political climate in their city or state will support authorizing legislation. Not surprisingly, these types of arrangements raise numerous, complex political issues.

Another important consideration is the value of transferring the risk to private investors. In a P3, private investors (often referred to as concessionaires) take on many of the risks of a project for up to 50 years, and in some cases longer. These include cost overruns, meeting necessary standards, and dealing with maintenance issues. However, owning these risks does in certain cases have value. This risk value must figure into the financial equation when assessing whether a P3 or a traditional procurement route is the best way to go.

Timing should also be a consideration. Our experience suggests that P3 projects can be delivered faster than traditionally procured projects. But this is only part of the “timing” equation. In certain instances, a state or municipal agency can afford to deliver a new project, but is financially constrained by bonding limits. By using a privately financed P3 structure, a much-needed infrastructure project may be completed many years earlier than if the agency had waited for municipal bond proceeds to become available. Choosing P3 financing in this scenario often has significant economic benefits to the region and public beyond the purely financial elements of the deal.
Long-term issues require focus

The second layer of issues to consider, which address the long-term feasibility of the project, requires decision-makers to tackle three essential questions: Is the project technically and financially feasible and is there buy-in from key stakeholders?

Technical feasibility is simply an evaluation of whether a project is technically suitable for a P3 structure. As many P3 projects are structured using long-established project finance techniques, they don’t lend themselves to constantly changing requirements. As such, concessionaires may be comfortable taking on a stable asset for many years in return for an annual payment that is subject only to an inflation adjustment. Roads, bridges, and buildings generally fall into this category because they are largely a known quantity when it comes to pricing long-term risks. IT assets, on the other hand, which are subject to constant and rapid technological change are much more difficult to price and may be less appealing to investors.

One of the most important considerations is financial feasibility. When assessing whether to proceed as a P3 or a traditional design, bid, build project, it is important to develop an “apples to apples” comparison of the two approaches. To do this, KPMG typically builds two financial models that incorporate project costs throughout the life of the concession. The first model incorporates all the costs from the public sector side with the municipal financing structure typically adopted by that agency. The second model anticipates the way a typical concessionaire would structure and finance the project using a mix of risk capital and project finance loans and/or capital markets products. When both models have been completed, government agencies have the advantage of comparing both to help determine which route to pursue.

Getting buy-in from stakeholders is critical and education is often a key element. There will always be opponents of something new and successful P3 projects across the United States have had to navigate these issues. Public officials need to be able to thoroughly explain how they evaluated the project before reaching their decision. Stakeholders need to be engaged and must get timely answers to their questions about whether and how they may be affected by a P3. If the government entity can’t demonstrate to its constituents that the benefits of a P3 outweigh potential drawbacks, it needs to re-think the project.

Finally, governments need to make sure that there is a market for their P3 project. Market appetite can be evaluated by understanding if the project is the right size to attract a sufficient pool of viable bidders. Other considerations include if there is sufficient capacity in the financial markets to finance a major project and if competing projects in the same market will create capacity constraints.

Conclusion

Government agency budgets have finally begun to recover after years of financial duress. At the same time, public officials at all levels are increasingly looking for innovative ways to fund desperately-needed infrastructure projects. P3s can be a viable alternative to traditional municipal debt financed projects, but any such project should undergo a vigorous review to determine which route is best to go down before any final decision is reached.