Public-Private Partnerships:
What You Need to Know

Where is the public-private partnership (P3) revolution that has been heralded by public officials and AEC practitioners? In spite of a historic need for infrastructure development and replacement, the movement has been slow to gain traction in the U.S., while P3 models have thrived overseas. So what are we waiting for?

A tipping point, perhaps. The message from last year's U.S. P3 Infrastructure Forum, hosted by InfraAmericas in New York in June and attended by key players from the AEC industry, was that "P3s breed P3s and they are here to stay." Proponents argued that the more (successful) P3 projects that are completed in the future, the more confidence and trust the general public, industry stakeholders and government officials will have in these complex finance and delivery models. After all, success breeds success.

Despite such optimism, advocates admit that many obstacles must be cleared before a broad-sweeping P3 revolution can take place in the U.S. As one executive from a large construction company put it, "There have been a number of P3 failures. Projects have been canceled, owners couldn't get the approval or the financing lined up for one reason or another – it's just not a real crisp process and that has caused a lot of heartburn for players that invest millions of dollars into the pursuit of these projects." The recent cancellation of the West by Northwest P3 procurement in Georgia is the latest example of setbacks the industry has witnessed.

The following article provides an outlook for the U.S. P3 market and offers insight and recommendations from various stakeholders, including contractors, concessionaires, consultants, lawyers and owners, on how to get involved and succeed in today's P3 market. Information was gathered from interviews with more than a dozen industry leaders as well as FMI experts and provides a concrete basis for understanding the key issues and opportunities related to P3s.

On the cusp of a revolution

Setting the stage

Project delivery methods across the U.S. have evolved predominantly at the state level, shaped by the laws, regulations and politics of state and municipal legislatures and councils, and influenced peripherally by national initiatives, such as the Federal Aid Highway Act of 1956. While the U.S. Interstate system was conceived of and funded by that bill, civil works were contracted (and continue to be maintained) by state transportation departments. Likewise, laws like the Miller Act established bonding and procurement requirements for government contractors that advanced the cause of municipal projects, who had a tighter margin for error on an investment.

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www.fminet.com

"P3s have clearly come a long way from where they were 15 years ago. There is market momentum today but it's still an infant trying to grow up."

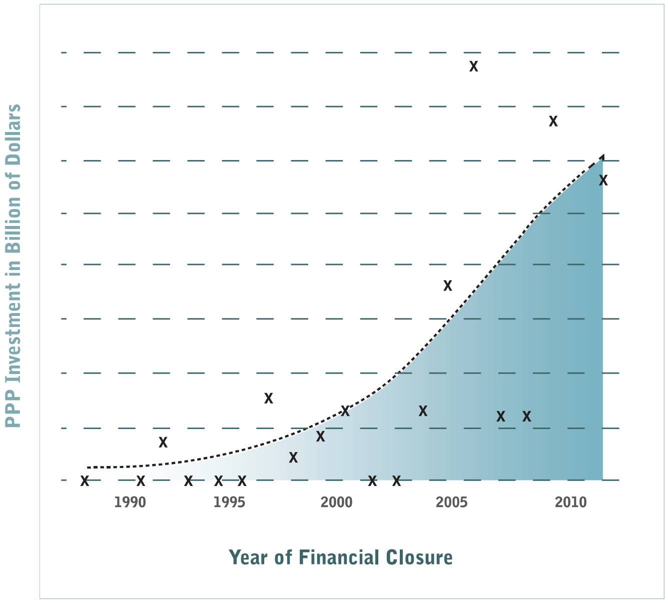
James Geer, Manager, Public Private Partnerships, Kiewit

State legislation has dictated the adoption of certain delivery methods, with design-build prohibited until just recently in New York by "Wick's Law," for example, and new laws paving a clearer passage for alternative delivery methods in government contracts. Such a piecemeal and slow-moving approach to overhauling the regulations that dictate contract delivery is why we see such divergence in construction delivery methods from state to state and from municipality to municipality today.

Further, regulatory change has met with a dynamic, fragmented and very diffuse design and construction industry at each step, pushing public-private partnerships to grow and evolve differently according to region and project type. In spite of such a slow uptake of P3 models in the U.S. due to this diversity, public-private partnerships have a 200+–year history in the U.S. – indeed, thousands are operating today.

In recent years, P3s have started to gain meaningful traction, predominantly in the transportation sector, as shown in Figure 1. Many industry analysts expect this trend to intensify, as P3s have proven a viable means to repair and upgrade infrastructure, particularly in a strained economy where public resources are limited and private capital is in need of strong, risk-adjusted investment opportunities. Today, more and more owners are looking for new and innovative delivery methods using state-of-the-art technologies that offer a broad variety of project components. Such alternative formats include Design-Build, Design-Build-Finance, Build-Finance, CM-at-Risk and varying "Integrated Project Delivery" arrangements; each iteration offers greater collaboration between stakeholders in a departure from the linear hard-bid contract, traditionally driven by the owner spec.

Figure 1. P3 Investment in the U.S. Transport Sector



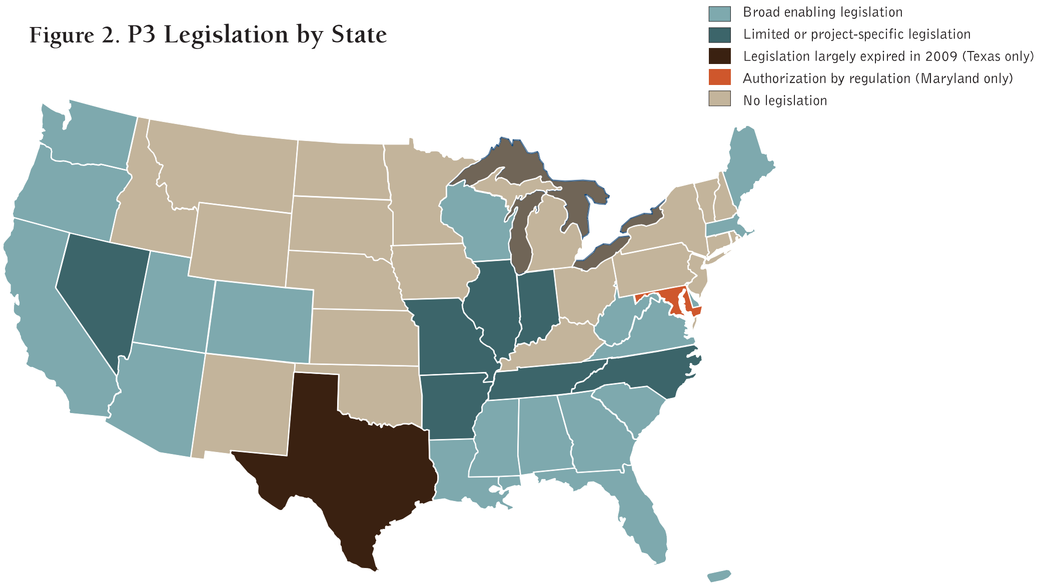
Source: Public Work Financing, October 2010, and other sources.

Across the country, alternative delivery methods comprise around 50 percent of nonresidential contracts; viewed in the context of these options, P3s represent not a new model, so much as a place on the continuum between wholly owner-driven projects and purely collaborative, shared-risk models of project execution. Some of the variations at the highly collaborative end of this continuum will bring in additional deliverables like operations and maintenance, as stakeholders find more ways to derive value from a project.

The continued evolution of joint public-private endeavors has been fueled by the payoffs that come from sharing resources and risk: greater efficiency, better access to capital and higher-quality, more cost-effective results than traditional funding methods. Public agencies are able to contract the ongoing monitoring and oversight of an operation; meanwhile, high-performance private firms bring their expertise to large-scale, long-term projects.

Despite the great need for funding, alternative finance and delivery models such as P3s have been slow to gain acceptance in both private and public sectors. As more states continue to develop legislation allowing for P3s, we expect greater standardization and consistency around P3 models, which will drive a broader acceptance of these types of projects in the U.S. Figure 2 identifies states that have already developed legislation around alternative procurement methods, including Design-Build-Finance. Some states, such as Virginia, California, Florida and Texas, offer more advanced funding flexibility; other states, such as Ohio and Illinois, have recently passed legislation allowing for P3s.

Figure 2. P3 Legislation by State



"Here in the U.S., the market seems very rigid and it takes a lot of effort to actually break through and challenge the old procurement system with a new model."

Magnus Eriksson,
Senior Vice President,
Skanska Infrastructure
Development Americas

Key hurdles to overcome

One of the fundamental issues slowing a broad P3 acceptance here in the U.S. is the lack of understanding of what public-private partnerships really are. James Geer, manager of P3s at Kiewit, sums it up: "I think there is still a tremendous lack of understanding of what P3s are all about, what value they bring and, ultimately, where its place is in the market. From the owner's perspective, you've got 50 states that each have a different way of looking at things, combined with varying degrees of enabling legislation. When you have that much diversity and decentralization of the decision-making process – at the project delivery level – the education process takes time."

Part of the challenge of educating people around P3s is directly associated with the complex nature of these projects. Public-private partnerships are typically highly complicated deals involving dozens of stakeholders, with diverse business backgrounds and mind-sets, and are often embedded in a complex political environment. For many contractors, the idea of getting involved in these types of large, multifaceted projects is very intimidating, and often it is not entirely clear to many firms how they would participate in P3s, or even if they could. Geer states, "AEC industry professionals have become very comfortable with traditional project delivery models: They understand the risk profile, the relationship dynamics, the owner profiles – and they know how to be successful in that world. Therefore, when you disrupt that environment, there's a fear of loss of control and market share. And that's always hard; you're asking folks to do something new and different. So there has been an industry resistance up until recently, but I think all that is slowly starting to change."

Despite the industry's slow-to-change mind-set and the high level of uncertainty over what P3s are all about, knowledge and agility among both contractors, construction managers and other stakeholders is building, with interest in P3s piquing at local, regional and national levels. The impetus for firm leaders to move beyond the traditional business model has received a bump from the difficult market environment: Scarce resources and hard-fought opportunities in the industry have seen contractors look for greater autonomy over procurement to enable their companies to stay working.

The following section provides insight on best practices from contractors and concessionaires who have established themselves as leaders in the U.S. P3 market.

Partnering up: the savvy contractor

Through in-depth interviews with more than a dozen P3 industry leaders, as well as FMI experts, we uncovered several tactical strengths that help contractors get started with P3s, from both a business and operational standpoint.

1) Build your expertise through strategic joint ventures. Pick your partners carefully.
Most interviewees described P3s as a completely "different animal." What you learned in previous construction jobs does not necessarily apply to P3s. Therefore, it is important to start cautiously, educate yourself as you move along, and work with experienced project partners – ideally, trusted partners with whom you've had successful prior experience. When selecting the right partners, the lowest bid is not always the best choice when you are hoping to form a long-term relationship in which both your futures are invested.

This is the time to consider new types of partnerships and joint ventures. For instance, several U.S. contractors are currently working with FMI to explore new types of alliances with financial institutions in order to set up consortiums offering a wide array of P3 services.

2) Plan comprehensively for project complexities. Be smart about your business decisions.
P3s are typically very complex, large-scale projects. It is therefore ever-more important to know what to expect of the partnership beforehand and to outline expectations and responsibilities at the outset in an extensive, detailed contract. On top of that, a conflict-resolution contingency should be on hand to deal with inevitable disputes, whether large or small. Always keep an open mind and be ready to resolve issues at every step of the way. As Dusty Holcombe, deputy director of the Commonwealth of Virginia's Office of Transportation Public-Private Partnerships, says, "This is marriage without divorce. If you have a 50-year term where you've got construction, operations, maintenance and financial elements within the agreement, then you need to work it out how to achieve common goals, and once an agreement is in place, the partners work things out if you have any issues during the term. It's a long-term relationship."

3) Understand the cost and risk barriers to entry. You need deep pockets and a thick skin.
Due to the magnitude of P3 projects, contractors are often required to provide proof of strong balance sheets and solid bonding capacity. More often than not, the concessionaire will require a large (i.e. financial) parent company to back the performance of the design-build, and request very large Letters of Credit (LOC's) as additional performance guarantees of the design-build in order to meet the lender's requirements for backing the deal with debt. While the

amount of equity a firm looks at fronting is one obvious consideration, the issue with greater potential impact on a firm's balance sheet is the financing risk it is taking on. P3s bring with them greater risk in terms of a longer life cycle, larger scale of liability and heightened vulnerability to changes in external dynamics as the project progresses, for example, changes in public administration. Magnus Eriksson, senior vice president, Skanska Infrastructure Development Americas, emphasizes the novelty of new arrangements: "First of all, you have to understand the difference in risk allocation – the additional risk in a P3 project you are required to absorb as a contractor (especially if you're an American contractor) – it's probably something you've never seen before."

The intricacies of risk allocation often present new ground for contractors to cover, with different specified liabilities for various portions of a project – usage, travel, hazmat, archeological and revenue risk, for example – assigned to either public or private parties (see Figure 3). David Hatem of law firm Donovan Hatem, LLP, states, "AEC firms participating in P3s may find themselves on unfamiliar legal ground. Risks not typically dealt with by private entities may be transferred to them in a P3. Some of this is not insurable risk."[1]

Figure 3. Risk Reallocation in P3s

POTENTIAL RISK	Typical Private Sector Responsibility	Risk Shifted to Private Sector in PPP
Major environmental risks	No	Maybe
Usage rates, travel, and revenue	Never	Not Likely
Conflics, delays from unknown historical conditions	No	Yes
Conficts, delays from unknown archaeological conditions	No	Yes
Conficts, delays from unknown endangered-species conditions	No	Yes
Conflicts, delays from unknown utility conditions	Maybe	Yes
Cost and delays rom unidentified hazardous waste not cause by contractor	No	Yes
Accuracy of design and survey data	No	Yes
Geotechnical and soil conditions	No	Yes
Differing site conditions	No	Yes
Delays from legal action against the project	No	Yes
Delays from public interference	No	Yes
Right-of-way acquisition cost, and time to procure (need the public entity's right of eminent domain)	No	Likely
Changes in zoning, laws or rules that may affect the project	No	Yes
Delays by the grantor and/or other agencies	No	Yes
Insurance coverage	Partial	Likely
Up-front costs to design and develop project	No	Likely
Long-term liability exposure for maintenance, structures	Maybe	Likely
Long-term liability exposure to litigation	Maybe	Maybe
High and unusual liquidated damages for delay	No	Likely
Extraordinary guarantees	No	Likely

Source: "Focus on Insurance: New Alignments, New Risks." www.construction.com. From the Association of General Contractors Constructor Magazine, May-June 2009.

4) Be very strategic about the projects (and owners) you go after. Preparing bids for P3 projects can take years and millions of dollars of investment. Therefore, it is paramount to have a deep understanding of the owner's "ecosystem" (What is his budgeting process, timetable and constraints? What does his decision-making process look like? How is the public agency run?) and the viability of the project, which is often dependent on the public

1 Jerome A Guerra. PSMJ's AEC Issue Brief: The P3 Revolution. PSMJ Resources, Inc. May 2011.

"P3s have a higher risk profile than your average construction project, so you don't pursue them necessarily with the same kind of staff. You get more senior management involved with a P3 pursuit; the overall investment is typically significant and the time frame for preparing the bid can be very long. Therefore, you only want to do that on projects that are real and which have fair procurement and contract terms."

Matt Girard,
Executive Vice President
Business Development,
Flatiron

and political context. Jane Garvey, North America chairman of Meridiam, explains, "Strategically, we focus on those areas where there is P3 legislation, where there are real champions. I think you really have to understand the power structure of each of these individual states and examine whether the P3 legislation is workable. We also look at the criticality of the project, that is, is it important enough to a region to survive many administrations and potential political changes."

As part of this reconnaissance phase, it is also important to identify public agencies that understand what types of public policy goals they are trying to achieve and promote. If a proposed project has lots of public support, has already overcome some key hurdles (such as environmental impact assessments), and is part of a more comprehensive agency program, then chances for a successful P3 deal increase dramatically. If, on the other hand, an agency is just trying to do a P3 because it doesn't have sufficient funding and it appears to be a one-time type of deal, then the risk of failure is much higher.

5) Get in the door early. Start building relationships with public officials and finance representatives now. P3s require commitment and support from very senior public officials, who must be actively involved in supporting the concept of P3s and taking a leadership role in the development of each given partnership if they are to succeed. Start conversations with public officials and finance representatives long before projects have been announced. Understanding both their project needs, as well as the P3 process, is key to building trust with a given stakeholder – crucial if they are to personally invest themselves in a P3. Long-term relationships with key influencers will help you shape and develop P3 projects from the onset. Greg Ciambrone, vice president at the Walsh Group, states, "It's a grass-roots approach. The industry as a whole has to meet with states and municipalities, and the DOTs, to educate them on what tools are available to solve their needs. Contractors, at least the financially strong contractors, could be part of the solution (not whole solution). Dialogue is needed within the industry to search for different delivery methods. It will take continued education with public officials to let them know what works and what doesn't work."

6) Collaborate and innovate. P3 projects are highly complex and collaborative in nature and therefore cannot be run in a silo-type manner. New emerging technologies, as well as owner demands, are pushing design professionals and contractors to work as a cohesive team from the outset, communicating and approaching projects more holistically. As part of this effort, it is key to build strategic alliances with reliable partners and to develop a deep network of companies that are team players, open-minded and innovative. Experience in design-build-type delivery methods as well as a background in finance, operations and maintenance are a huge plus and can help your company differentiate itself even further. Holcombe states, "I think contractors just need to keep an open mind and not just focus on what was done in the past. This whole P3 concept is innovative, so they need to think of innovative ways to get these different things done and not dwell on what was a market precedent seven years ago."

Lessons learned from P3 projects

Even though the public and private spheres operate under different pressures, each is now recognizing the profound value a public-private partnership can bring, both in an economic and social sense. On the private side, high-profile public projects can build a firm's reputation and cement ties within a community or region, at the same time contributing to the socio-economic health of that particular locality. Firms also find that P3s provide an opportunity to broaden their reach into new products and services, as the project demands all parties to innovate. For public-side stakeholders, the P3 model brings with it an injection of equity that can make a crucial project happen. The advantageous arrangement under which the public and private entities perform to their specialties (in terms of project management, technical skills, project benchmarking, and operations and management) also ensures a high return on investment.

Beyond the complementary benefits of public and private entities attracting a counterpart to contribute their strengths to a project, there is a very real synergy that can be tapped through collaboration that renders the final product greater than its individual parts. Solid partnerships offer a deep understanding of the needs of each stakeholder and provide a means to facilitating the work beyond what is seen on a typical arm's length commercial relationship. Establishing a synergistic relationship begins with a few select factors:

1) Clear vision and strong commitment from the owner's side. Interviewees agreed that a successful P3 project starts with an educated and well-informed owner. It is important for the public agency to define a clear vision that indicates tangible objectives and outputs and shows clear benefit for the community. It is also critical for the owner to be committed to the process and to understand what the delivery model can bring to the table. Visible leadership by one or two high-profile champions in the public and private sectors can help kick-start the initiative and attract partners from a broad spectrum. A well-defined public relations program and open communication are critical elements of this effort.

2) Criticality and viability of a project. The political environment, as well as the project's longevity (Can it survive the transition from one administration to the next?), are fundamental to a P3's success. If the project represents a critical link or component of the community's infrastructure, then both political and public support are more likely. For example, the Long Beach courthouse deal in California was closed in a transition period between two very different administrations. The courthouse represents the largest courthouse in California, in terms of number of cases, and it houses very influential judges; it is critical and essential to the justice system in the state. This particular P3 is an availability-based infrastructure project and is the first such courthouse P3 in the U.S., though similar projects have been carried out in Australia, Canada and the United Kingdom.

3) Motivated partners whose interests and capabilities are aligned with the overall initiative. The P3 project must tap into interests of partners from multiple sectors to produce sustained engagement. It is important to understand and articulate a clear rationale or "case" for involvement, which may be different from one partner to the next. It is also critical to clearly communicate requirements and benefits to avoid unrealistic expectations and misunderstandings further down the road. Geer believes that, from an internal perspective, "It's working with a team that is committed to the project, bringing together true complementary capabilities." Further, he explains, "On projects that turned out well, we've had a like-minded business philosophy and approach to successful project delivery with everybody's incentives aligned to make it happen."

"It's a complex and expensive process. I would like to see owners start the procurement process with a well-defined program, including good design parameters and a realistic procurement schedule, and stay with it. Changes made during the pursuit often drive costs up, which is not good for the industry."

Ed Olsgard,
Vice President
– Strategic Initiatives,
PCL Construction

"I think to truly get the U.S. P3 market to take off, owners need to do their homework with their consultants, like taking care of third-party issues related to permitting and right-of-way-type matters, set up an open and transparent procurement, and then let the private sector do what the private sector does best: compete. The private sector will bring the innovation, bring the ideas and it can be not only a fast procurement, but also a very financially beneficial one for the owner."

Matt Girard,
Executive Vice President
Business Development,
Flatiron

4) Well-defined P3 coordinating mechanisms. Some states have a full-time P3 program management office – for example, Virginia's Office of Transportation Public-Private Partnerships – that are responsible for developing and implementing a statewide program for P3 project delivery. Central coordination helps expedite the delivery of projects, promotes transparency and accountability, coupled with informed and timely decision making, and provides consistent processes and procedures, which in turn encourage private sector investment. Holcombe explains, "We understand that some states have not implemented or don't fully understand P3s, but Virginia has a history in it. The development of this office (OTP3) and the commitment of our resources (internal/external) all have the objective to get these projects done. Therefore, our goal is two-fold: getting the projects done and setting up a project pipeline for a sustainable long-term program."

5) Effective communication channels. Public outreach is one of the most critical components of a successful P3 project. Experienced owners and project stakeholders take the time to educate the public about P3 projects to make sure that citizens understand the purpose of a project and how it meets the needs of the community or the state as a whole. Skilled owners have comprehensive communication plans in place, composed of a mix of private and public sector staff. Public outreach is a vital education process and can help break down common misperceptions of P3s, such as the idea that foreign companies come into a community to take over infrastructure assets.

Gilbane Development Company — A Case Study

Gilbane Development Company – one of the two companies that form Gilbane – collaborated with Loudoun County, Va., to consolidate its scattered operations into two locations. As part of this effort, Gilbane worked closely with one of the local communities, the town of Leesburg, to identify the most suitable location for the Loudoun government offices and explore innovative financing options. In the course of the project, Gilbane formed a special purpose entity, which effectively became the property owner for the proposed facility. Under this scenario, Gilbane took on the role of developer and reported to the property owner (the special-purpose entity, in this particular case). This arrangement allowed Gilbane and the consortium to use tax-exempt bonds and implement a highly effective financing solution, which created more than $1 million in total annual savings (or $22 million cumulative savings over the entire lease term) for Loudoun County.

Loudon County experienced some key benefits from adopting this type of public-private partnership:

1) **Reduced occupancy costs.** Overall, the county will save $22 million over the lease term.
2) **Accelerated timeline.** The county was looking at a three-year time frame to consolidate all of its operations into two locations. Gilbane was able to compress the project schedule to 18 months.
3) **Risk transfer.** The county outsourced all the financing, design, development and construction risk to Gilbane, which resulted in savings of approximately 10% of the total project costs.
4) **A high-value product.** The final product – a 158,000-square-foot, five-story government center – including administrative headquarters and a 418-car garage – is a success and meets all the county's needs.

Groundwork for success on the Loudoun County P3 project:

1) The client (in this case Loudoun County) had a clearly defined need for what it wanted to accomplish (consolidation of scattered operations).
2) The P3 team offered complementary skills and strong synergy. Everyone moved in the same direction.
3) Visible leadership and strong public support. The project was endorsed and promoted by champions in both the public and private sectors. There was a strong commitment on the public side to get the project done.
4) Gilbane offered very creative and innovative ways of getting the project done. Having a deep portfolio in project development, financing and ownership helped Gilbane understand how to integrate the myriad components of the project delivery and ownership structure for this deal.

"These types of projects require a broader skill set in order to coordinate all the different pieces of design, finance, construction, balance of risk, acceleration of the schedule, and dealing with public entities. It really takes a different kind of business acumen."

Ed Broderick,
Executive Vice President,
Gilbane Development Company

Biggest challenges for contractors

Interviewees mentioned that owners who lack a deep understanding of and commitment to the process and who keep changing the scope or nature of the structure of the deal can be detrimental to this kind of undertaking. Likewise, owners who try to push all the risk onto the private sector can lose credibility to the point where the economics of a deal start to come apart. Geer explains, "We try to be very proactive with the owner and all of our partners when it comes to risk allocation. At the end of the day, placing the risk with the party best positioned to manage it leads to the most cost-effective pricing. So that evolution and dialogue, between the owner and the team, is always the one that we find challenging, particularly with a state new to P3s."

The competitive landscape here in the U.S. is also starting to transform. According to Ciambrone, "We're seeing a lot of large international contractors entering the U.S. market so we're experiencing a globalization of the U.S. P3 market. With this influx of new competition, it's becoming difficult for U.S. contractors to compete because they don't have the qualifications – at least on paper – compared to some of these international competitors."

Further exacerbating an increasingly diverse competitive environment is the relative inexperience of many new (domestic) market participants. Often they don't have the necessary in-house capabilities, aren't really committed to the process, or simply don't understand the sophistication of the business. This can also hamper the success of P3 deals, which in turn results in negative press and public misperceptions. Larry Baker, lawyer at Watt, Tieder, Hoffar & Fitzgerald (WTHF), explains, "You are going to get more and more people interested in participating in these types of procurements who have no background. And the best advice you can give them is: 'Don't screw it up on the front end because if you do, it's too late and you'll step into quicksand that you cannot escape.'" That said, as domestic players become more educated and skilled around these complex delivery models, the U.S. P3 market will likely grab a stronger foothold and enjoy superior stability and reliability over time. Further, successful partnering (joint ventures) can assist the skills transfer between domestic firms, building greater P3 capability and knowledge capital within the U.S.

"Our biggest challenge is really getting a firm understanding of how real the project is. The biggest stumbling blocks we face include: poorly defined project goals, poorly drafted agreements and inefficient allocation of the risks."

Greg Ciambrone,
Vice President,
Walsh Group

Labor issues to consider

While public projects bring with them unique labor regulations and constraints, P3s have tended to be singled out as anti-union by some factions, due to the private sector recruiting "leased" employees for public projects, for example. However, some players, such as the reputable investment manager Ullico, have a strong labor policy and labor experience and can add significant value to a P3 consortium, particularly in areas where there is a high union presence. Sonia Axter, managing director, Infrastructure Investments at Ullico Investment Advisors, Inc., explains, "Our corporate mission is to provide solutions for the union workplace. Our firm believes that union labor creates value. Therefore, our participation can enhance a proposal when the public agency knows that it has someone on the team who cares about union issues and can proactively manage union-related issues during the project." Considering labor issues and related political ramifications is very important when responding to a P3 solicitation; they often can make or break a deal – long before the proposal is even submitted.

Working with the public sector

Working with the public sector may present new opportunities as well as unforeseen challenges for many companies otherwise struggling to keep a full backlog. When it comes to P3s, public agencies are primarily looking for innovation, creative financing solutions and ways to bring value from the private-side team. Often, preparing a proposal for a P3 solicitation can take several months or even years with no foreseeable return on the investment. Successful contractors are therefore very strategic and selective about the projects they pursue and the relationships they cultivate with public entities.

When forging relationships with public agencies, owners encourage contractors to pay special attention to the particular processes and policies unique to each agency. Dusty Holcombe, deputy director of the Commonwealth of Virginia's Office of Transportation Public-Private Partnerships, states, "The private sector certainly has to make business decisions on where they want to invest their dollars. I think the private sector just needs to be aware of the fact that there are many different issues, processes and policies in place in these different jurisdictions where they're trying to do business. If they're going to do business in Virginia it's going to be a little different compared to Texas, and a whole lot different compared to California."

Eugene Schiller, deputy executive director at Southwest Florida Water Management District, has observed and participated in the development of state and local public-private partnerships on the government side for almost 30 years. He says, "Frankly, you (the private sector) need to better understand the dynamics of government entities you are approaching. Local governments, much like for-profit companies, are truly living organisms. They have life cycles; they grow, get sick, grow old and reflect changing economic conditions. You must take the time to understand your client governments' life (history, culture, threats and opportunities) if you are going to have a chance to communicate to elected and appointed decision makers why your proposal is a better option than doing nothing."[2]

2 Eugene Schiller speech. "Why don't they understand?"

At a minimum, Schiller suggests exploring the following questions before approaching a public entity or its elected officials:

- What type of government is in place? How is it organized?
- Who are the elected officials? Who is in charge?
- Who are the key appointed officials
  (e.g., city manager, chief financial officer, utility director, etc.)?
- What are the financial conditions and long-range plans? Are they able to do a deal?
- How experienced are they with recent bond issues?
- What do the state and local laws look like? Do they have P3 legislation in place?
- What is the media situation? Can you innovate without getting beat up?
- What does the overall economic climate look like? Can they afford and support a deal?

These are just a few of the many topics contractors need to familiarize themselves with before delving into a P3 partnership. The other major takeaway from the owner interviews is that public-private partnerships are true long-term partnerships. Holcombe explains, "Once you have a partner in place, you've got to come in with a perspective that they are partners – they're not the other side or the enemy. They are partners and everyone has a common goal. You may disagree about things, you may not have the same philosophy on how financial or commercial issues ought to be addressed, but you've got to stay focused on the larger picture of how we're going to get this project done and how we're going to work as partners."

A high level of trust and open communication among all project participants is critical to these long-term partnerships. From the outset, owners like to see contractors and other stakeholders be honest and transparent about their financial state of affairs in order to get a better grasp of the risks involved. Mike Heiligenstein, executive director of the Central Texas Regional Mobility Authority, sums it up: "I think we really have to be clear about where your books are. The more a private sector firm appears to be in a bunker mentality and unwilling to be transparent, the more difficult it will be to develop a long-term relationship built on trust. In our case, we try to set an example of the level of financial openness and transparency required in this market. It is a risk factor that the private sector really has to help us mitigate – who our partners are and how open they are."

Finally, having a strong portfolio of P3 projects (in various shapes and forms) is often a prerequisite for even being invited to the table. Contractors who have experience in design-build (or similar types of alternative delivery methods) are already ahead of the curve. As mentioned, if you don't have a deep project portfolio of P3s, then building strategic alliances and joint ventures with experienced and reliable companies can be a good way to get started. Heiligenstein adds, "I think good bench strength and experience with our agency's design approach are critical. You want to find partners who are knowledgeable about the process and are able to make sure that before they sign the agreement they understand all contractual obligations and what they are getting into." Eriksson, Skanska Infrastructure Development Americas, adds, "Skanska is probably one of the few U.S. contractors that self-performs more than most other contractors in the P3 space. Even so, we would always subcontract out maybe 40%, 50% or up to 60% of the work anyway. So, on that level, there is still a lot of work to be performed by smaller contractors who might not be able to take on the headline liabilities."

"I think whether you're on the public or private side, we need to educate ourselves more about our partners' background and business mind-set and learn how to speak each other's language."

Marta Bede,
Assistant Vice President,
Maritime, New York City
Economic Development
Corporation

"I think the P3 market will advance more rapidly if the private sector can do more to help the public sector understand how these sophisticated financial models can address the complex challenges that policy decision makers are faced with."

Dale Bonner,
Founder and Principal,
Cal-Infra Advisors, Inc.

What does the public sector client think about P3s?

The following information was presented by McGraw-Hill Construction's Rusty Sherwood at SMPS Tennessee on March 24, 2010. Below are "Tentative Insights from the Ongoing MHC Survey of Government Decision-Makers":

- 40% expect P3 work in next three years
- A third have a high opinion of P3s
- Most important financial aspects: guarantees and default provisions
- Congestion has the highest priority in a decision to use a P3
- Lack of funding is the primary reason to use a P3
- Biggest concern with P3s: unacceptable private profits

Where to from here?

Success breeds success and we seem closer to a tipping point than ever. Looking ahead, industry practitioners agree that as more deals are closed in the next few years and more success stories are experienced at all levels – by communities, policymakers and industry practitioners – P3s will thrive. As additional P3 projects come online and demonstrate the value proposition of such an arrangement, states and localities will get a better sense of the benefits P3s offer and can therefore benchmark their efforts against these types of projects more easily.

Given today's economic constraints and the huge need for infrastructure development and replacement in the U.S., P3s are well-positioned to become more widely accepted – for both economic infrastructure (e.g., roads, bridges, railways, etc.) and social infrastructure projects (e.g., hospitals, courthouses, water treatment plants, etc.). At this time, there are several RFPs and RFQs outstanding that reflect the trend of owners getting more comfortable with P3s, suggesting that we will see many more projects of this type proposed by government entities in the years to come.

While it is unlikely that P3s will become the dominant delivery model in the future, we expect the model to thrive in certain pockets in certain states; it will certainly represent a sizable, robust niche market worth considering in the future. Before delving into the P3 market, though, contractors need to be aware of the many intricacies involved – at the political, public and industry levels – that shape this complex market. Michael Loulakis, president and CEO of Capital Project Strategies, sums this up: "You have to decide why you're doing it." As with any other business strategy, P3s in particular take thoughtful research and long-term relationship building due to the high stakes involved.

Firms like Kiewit, PCL Construction, Flatiron, Gilbane, Clark, The Lane Construction Corporation, Zachry Holdings and the Walsh Group, among many others, are proof that contractors can be very successful in delivering these types of projects in the U.S. As P3 knowledge begins to percolate through midsized contractors, we can expect an efficient, high-quality U.S. brand of P3 to emerge and compete with other delivery methods. For those who know how the game works, and who are prepared for a steep learning curve, the potential to change the scope of the future is very real. As one A/E firm executive put it, the P3 market is an opportunity "you ignore at your own peril."[3]

3 Jerome A Guerra. PSMJ's AEC Issue Brief: The P3 Revolution. PSMJ Resources, Inc. May 2011.

For more information on how FMI can help you tackle the acute challenges facing your firm, please contact:

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