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Forging the Institutional Framework for Public-Private-Partnerships

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Infrastructure and Service Delivery through P3

Adequate infrastructure is a necessary precondition for successful and sustainable economic growth. Public authorities at the federal, state and local level, however, often have limited financial resources to invest in the development, modernization and expansion of their basic infrastructure and services.

For this reason, public authorities across the globe are increasingly turning to Public-Private-Partnerships (P3) in order to meet their core infrastructure needs, as well as to ensure that infrastructure and services are delivered more efficiently and cost-effectively.

Public-Private-Partnerships refer to long term contractual arrangements between public authorities and the private sector which aim to ensure the financing, construction, renovation, management, operation and/or maintenance of public infrastructure and services.

Through an infusion of private capital and management, P3 can ease fiscal restraints and boost efficiency in the provision of public infrastructure and services. P3 have demonstrated their benefit by delivering shorter delivery times, better value for money, and increased innovation across a range of sectors. They can also be used effectively as targeted policy tools for infrastructure revitalization and development.

P3 Drivers

Public authorities are mainly driven to consider P3 and other alternative finance and delivery options for one of the following reasons:

1. **Access to Additional Financial Resources and Delivery Structures:** As public authorities seek to modernize and expand their core infrastructure and service offerings, they are often confronted by debt ceilings and fiscal constraints. By leveraging third party debt and equity, public authorities can accelerate infrastructure delivery, while likewise incentivizing capital savings and performance improvements. Indeed by combining private finance and delivery, on average, infrastructure cost savings range between 10%-15% in comparison with traditional publicly funded design-bid-build structures.

2. **Monetization of Existing Assets:** As public authorities confront the fiscal strain of building, operating, and maintaining major infrastructure assets, many are seeking creative ways to unlock the value trapped in their current fixed assets. The key principle behind monetization involves leveraging assets to generate revenue to support the key public sector priorities. This can involve long-term concessions or leaseback arrangements for existing assets,

commercialization opportunities, and in some instances, even the sale/disposition of underutilized assets.

3. **Operational Efficiencies and Life-Cycle Savings:** In an effort to improve financial performance and/or capitalize savings, public authorities are also turning to incentivized performance contracts for the operation and maintenance of infrastructure assets. Performance contracts come in many shapes and sizes, ranging from Savings Performance Contracts and Peer Partnering[1] to long-term O&M concessions. Incentivized performance often means that the private partner is paid in full or in part on the basis of the savings it generates, while still being required to meet key performance output standards. Even in relatively well run public agencies, this revamped incentive structure has proven to generate significant performance improvements, with savings typically ranging anywhere between 15%-25%.

4. **Risk Allocation & Mitigation:** Likewise, public authorities are increasingly turning to P3 for risk management and mitigation purposes. A wide range of risks can be addressed through P3, including financing risk, construction and completion risk (i.e., construction costs, delay, performance, etc.), revenue/funding risks, cost risk (for O&M), operating performance risk, demand risk, technology risk, regulatory risk, etc. By allocating certain risks to an experienced and qualified private partner, public authorities can protect taxpayers from key project risks, such as cost-overruns, schedule delays and inferior operating performance.

While the benefits of P3 can be substantial, they are complex policy tools that must be carefully implemented to ensure the appropriate balance of financial, policy, and program goals. Well-structured P3s result in transactions that create value-for-money for taxpayers and rate-payers, without surrendering flexibility, control, and the achievement of the public sector goals. On the other hand, poorly structured or unbalanced P3s can be extremely problematic.

In other words, despite their potential, Public-Private-Partnerships are highly complex policy instruments that require specialized expertise and skills not typically found in the public sector. Therefore, in order to ensure that P3 projects and programs are successful, sustainable and able to achieve their economic and social objectives, governments are increasingly establishing dedicated institutional structures to manage and guide P3 programs and projects.

Making the right choices as to what functions such professional P3 entities should perform and how they should interact with executive agencies and other authorities responsible for infrastructure and service delivery is critical to ensuring that they add value and fit into existing governmental processes. This paper summarizes some of the key issues relating to the design and establishment of P3 offices.

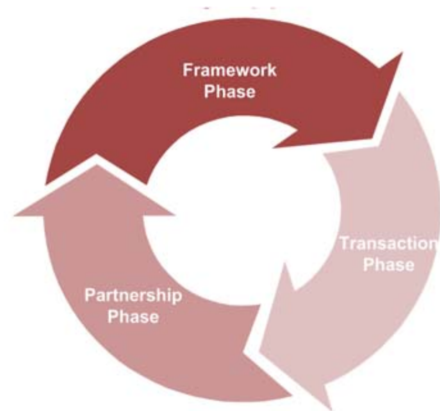
[1] Peer partnering refers to contracts where an external partner works with existing management and staff to identify and implement efficiency measures. The external partner is then compensated on the basis of a percentage of total savings. This is extremely common in some asset classes, such as water and energy utilities.

Benefits of a P3 Center of Excellence

Over the past decades, the most successful P3 programs across the world have benefitted from dedicated institutional structures that were designed to manage and guide both programs and projects. Whether advisory, regulatory or executive in nature, the creation of the appropriate institutional framework for P3 has demonstrated its effectiveness through the following:

- **Standardized Best Practice / Consistency of Criteria**. A centralized P3 entity helps to standardize best practice and eliminate the need to "reinvent the wheel" for every project. This is particularly important when a P3 program involves multi-sector projects being implemented by diverse local government entities, such as in the case of Florida. Best practice can involve as much or as little as considered appropriate for the jurisdiction in question, ranging from a simple repository of information to the creation of standardized contractual terms (templates) and processes. Consistency of criteria is critically important to protect the public against failed projects and mitigate implementation risks.
- **Enhanced Public Sector Capacity**. The ability to leverage "lessons learned", as well as to have access to best practice and experts greatly bolsters the public sector's ability to effectively utilize P3. It also helps to ensure that projects are implemented in a successful and sustainable manner, optimizing the balance of rights and responsibilities between the parties. Furthermore, the P3 entity serves as a "one-stop-shop" for advice and expertise, assisting public sector officials to better understand the requirements of P3 projects. All of these factors improve the capacity of public sector officials to apply P3 as policy tool.
- **Better Projects**. The existence of a specialized P3 entity or center of excellence has consistently yielded more balanced and sustainable projects by facilitating the application of best practice and providing policy makers with easy access to lessons learned.
- **Superior Efficiencies and Economies of Scale**. A specialist P3 office generally results in the more efficient implementation of projects, streamlining processes and reducing transaction times and expenses. In part, this is due to standardized criteria and procedures, which allow Government Entities to easily access and utilize pre-existing templates and procedures. Likewise, the P3 entity reduces transaction costs, allowing public officials to draw on a pool of existing expertise.
- **Heightened Private Sector Interest / Lower Risk Premiums**. A central P3 office does not only serve as a single marketing forum for a wide variety of projects, but it also helps establish the context within which individual projects are procured, financed and implemented. This often provides comfort to the investors and creditors, who may be unwilling to invest in one-off transactions. The use of standardized contractual provisions helps establish precedents which reduce the risk profile of individual projects, thereby lowering required financial returns.
- **Greater Transparency and Accountability**. A centralized P3 entity can serve as a single repository of information about all projects, thereby facilitating stakeholder understanding of P3 projects and processes. The centralized P3 entity typically publishes project performance metrics, allowing the public to evaluate project performance against other local projects, as well as against projects in other jurisdictions. This fosters greater accountability and transparency in the application of P3, providing greater comfort to the public while simultaneously incentivizing public officials to utilize this policy tool in the best manner possible.

The Role of the P3 Office within a broader P3 Program



At its core, the purpose of any P3 office or specialized entity is to contribute to the implementation of a successful P3 program. Whereas the definition of a "successful P3 program" will vary from jurisdiction to jurisdiction depending on specific P3 program drivers and objectives; in general terms, a successful P3 program entails successful and sustainable results across all phases of the P3 life-cycle. The P3 life-cycle is comprised of three principal areas:

FRAMEWORK

The Framework Phase involves the establishment and management of the legal, regulatory, institutional, policy and strategic framework for P3. There is a need for clearly articulated policies and priorities, as P3 transactions should be considered within a broader framework of public policy objectives. The Framework Phase likewise involves the creation of multi-sector or single-sector project pipelines and priorities, and the development of general policies, best practices, and guidelines regarding risk allocation, financial support mechanisms, etc. The Framework Phase is critically important to the eventual success or failure of any P3 initiative and responsibility for its management is often allocated to a single government authority.

TRANSACTION

The purpose of the Transaction Phase is to secure the best value for money in the delivery of public infrastructure and services. This is achieved through well structured transactions that are financially viable, while simultaneously achieving an optimal risk allocation that balances public and private sector interests. Feasibility studies, transaction structuring, investor outreach, procurement design, contract negotiation and financial close are all highly complex activities requiring specialized legal, financial, regulatory, and technical/operational expertise not commonly found in the public sector. As such, public authorities often turn to experienced transaction advisors, particularly during the early years of P3 program development. Nevertheless, public sector management of transactions and of third party advisors also requires specialized skills, a situation which frequently motivates public authorities to establish centralized and/or satellite P3 offices.

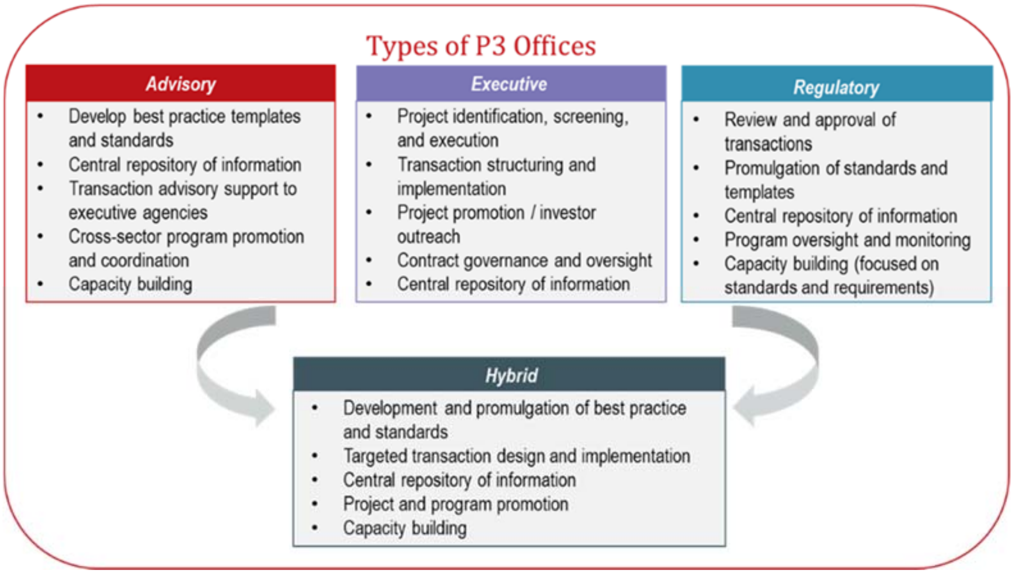
PARTNERSHIP

Often likened to a marriage, P3 contracts do not only assign responsibilities to the private partner, but they also confer obligations on the public partner. In order to minimize the risk of disputes or contract failures, public officials must be professionally competent in areas such as contract management, monitoring and enforcement. This involves activities such as dispute resolution, renegotiation and regulation. Indeed, successful and sustainable P3 programs require effective governance structures at both the project and program level, with the appropriate checks and balances. This is often achieved through the establishment of specialized P3 entities.

An effective P3 program is one that embraces the full life-cycle to foster successful and sustainable projects that provide needed public services, create value-for-money, and comply with general standards of good governance. Public authorities must work to establish the appropriate institutional structures to ensure the effective execution and management of all phases of the P3 life cycle.

The Purpose of a P3 Office

Whereas the tasks associated with the P3 life-cycle are more or less standard in all P3 programs, the role of a P3 office in performing those functions varies from jurisdiction to jurisdiction. In some jurisdictions, specialized P3 offices provide only advisory services and establish policy; while in others, offices are executive in nature, heavily involved in transactions and project implementation.



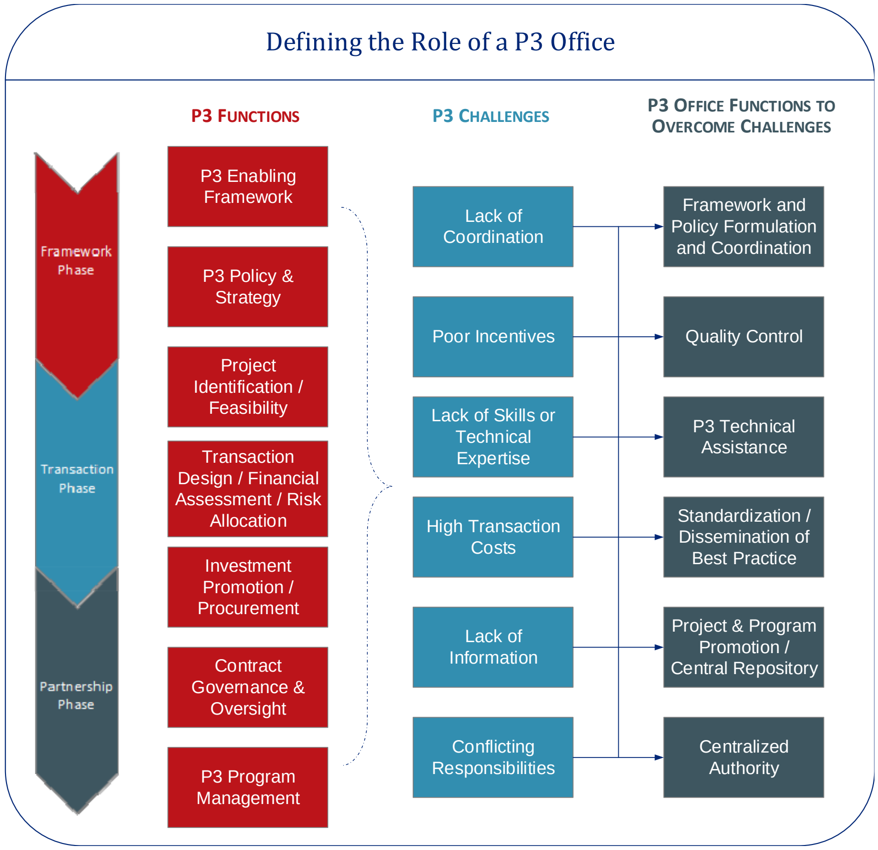
Although there are increasing efforts to establish standardized guidelines for institutional arrangements in support of P3s[2], for all practical purposes, P3 offices should be created to compensate for existing institutional weaknesses that limit a government's ability to manage a P3 program effectively and efficiently. This is to say, there is no single "one-size-fits-all" formula for establishing a successful P3 office. Governments will suffer from different institutional strengths and weaknesses in P3-related activities (i.e., procurement, contract enforcement, investment promotion, etc.) and therefore, P3 offices in different jurisdictions take on distinct structures and competencies. P3 offices do not respond to a cookie-cutter formula, but must be tailored in response to jurisdiction-specific program needs.

Throughout the P3 Life-Cycle, public authorities must perform a diverse number of functions. Specifying the public sector's weaknesses associated with each of these functions is a prerequisite to determining the optimal role that a P3 office should play.

When specific public sector weaknesses are present (i.e., lack of coordination or technical expertise), when public agencies and budget organizations are faced with poor incentives to structure sustainable projects that maximize value-for-money, or when other problems exist, specific functions and responsibilities can be assigned to a centralized P3 authority to overcome these deficiencies. This

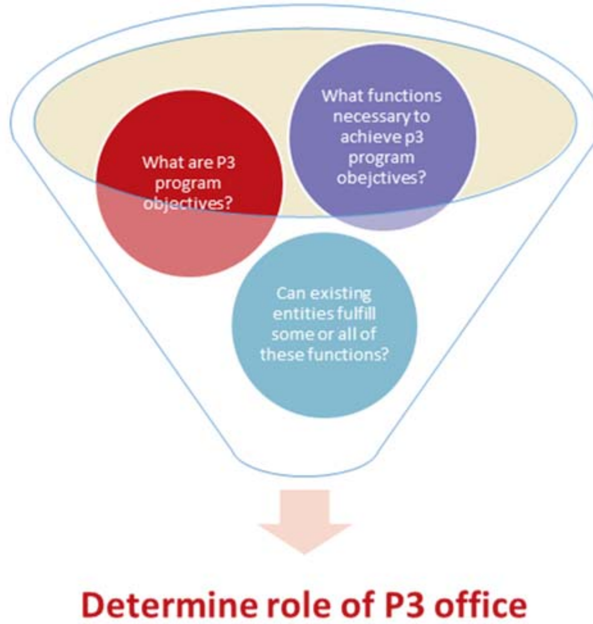
[2]For instance, in 2003, the P3 Alliance, sponsored by UN Economic Council for Europe, issued good governance guidelines for institutional arrangements established in support of P3.

compensatory method of defining a P3 office's functions and authorities has produced some of the most successful P3 offices to date. Examples of centralized P3 entities designed in this manner include Office of Innovative Project Delivery at FHWA, Virginia Office of Public Private Partnerships, Texas Facilities Commission's Center for Alternative Finance and Procurement, Partnerships British Colombia in Canada, South Africa's National Treasury P3 Unit, and Partnerships Victoria in Australia.



Experience has shown that the key to creating a successful P3 entity is matching its competencies with the needs of the corresponding P3 program. All too often, the random assignment of responsibilities to a centralized P3 entity creates institutional rivalries or confusion.

Indeed global and national experience demonstrates clearly that P3 offices have tended to work best when a government has designed a P3 entity to address a specific problem or objective, and when there is demonstrated political willingness to support the Office. P3 entities in Canada, Portugal, South Africa, the UK and Victoria (Australia) were created this way. Although each has a different purpose, they all worked well because the entities were designed with specific objectives in mind. Likewise, they were backed by strong political support and were placed within a system with adequate coordination mechanisms, enforcement power, and clear decision-making processes.



Put another way, policy makers first need to diagnose their particular deficiencies and assess whether a P3 office will be an effective solution to those problems. Once policy makers have defined their P3-related challenges, and determined that a centralized P3 office may indeed be the right solution to overcome those challenges, they should begin thinking about the *context* for the P3 office, as well as its specific roles and responsibilities.

Policy makers must make an honest assessment of their own needs and objectives. For instance, it is necessary to specify the objectives of the P3 program, as this in part will determine the role of a P3 office. For instance, a multi-sector or local government P3 program will likely require different support functions than a P3 program designed primarily to accelerate infrastructure delivery in a single sector (e.g., highways). Likewise, policy makers need to assess whether these functions can or should be provided by existing entities or if a new office or institution is necessary. An honest assessment of needs, objectives and existing capabilities will facilitate the determination of the ideal role of a P3 office.

P3 Office Start-Up & Design Considerations

Once the diagnostic phase is complete and the role of the P3 office has been determined, there are three fundamental design questions that must be considered:

1. The P3 office's responsibilities and functions
2. The office's level of authority
3. The office's appropriate location within government

P3 Office Responsibilities

The role and responsibilities of a P3 office tend to be quite dynamic, evolving according to institutional capabilities and policy needs. As an example, over the years of P3 experience in the United Kingdom, its P3 "*centre*" has been remodeled a number of times, with its terms of reference re-interpreted to meet the changing needs and evolution of the national public private partnership program.

Not *all* functions related to the P3 life-cycle or even to the P3 transaction cycle need to reside within a single P3 office. In the UK, for instance, they created a separate P3 Taskforce as part of Treasury, and a technical assistance/project development body with a public / private ownership structure, *Partnerships UK*. Some individual line ministries in the UK also have their own project development teams. When responsibilities are divided amongst agencies or when satellite offices exist in specific budget organizations, it is imperative that the lines of responsibility are formalized and clear to public and private partners alike.

Indeed the responsibilities of the centralized P3 office should be determined according to the needs of the P3 program. In some instances, this may mean that the P3 office will assume real executive responsibility for implementation of projects. In other instances, the P3 office may only act in an advisory role, leaving departments, agencies and/or other budget organizations to develop projects, conduct procurement processes, and manage the partnership phase. In some cases, the P3 office may simply serve as a coordinating agency or policy unit, leaving the promotion, project implementation and oversight to other institutions.

Despite the endless spectrum of possible responsibilities and tasks for a centralized P3 office, decades of international experience suggests that the more the P3 office is empowered to dictate process, to screen project proposals and to lead the conduct of tenders, the more effective and successful it tends to be.

P3 Office's Authority

When designing a P3 office or creating the institutional or legal framework for P3, it is imperative that policymakers take into consideration the authority that the P3 office requires in order to successfully meet its obligations and objectives. The authority and power assigned to the P3 office must coincide with its responsibilities and functions. For instance, if the P3 office is expected to have a quality control or quality assurance function, that office will require some sort of authority that allows it to stop or modify P3 agreements that are not well structured or are unfavorable to the public sector. Likewise, if a P3 office is expected to create policy and coordinate activities with agencies and other budget organizations, then it must be endowed with adequate authority to insist that these policies and procedures are enforced.

Often, the easiest way to grant authority to a P3 office is by association, by attaching the office directly to an existing government body that has the authority to stop or alter planned P3 agreements, such as in the cases of South Africa, Victoria and the UK. Increasingly, P3 offices are being empowered by law and backed by senior-level government oversight committees. In other cases, some P3 offices that have been created as quasi-independent bodies or agencies have suffered from insufficient power and authority to enforce their own decisions.

It is important to reiterate that the authorities assigned to the P3 office must be commensurate with its objectives and functions. A purely advisory P3 entity does not necessarily need enforcement power, while a P3 office responsible for standardization and dissemination of best practices will need some enforcement power, otherwise it is unlikely that agencies and budget organizations will feel compelled to apply these standards.

Location of the P3 Office

Unquestionably, the location of a centralized P3 office is one of its most important design considerations. Central P3 authorities generally fulfill a coordinating role within the government and their level of success depends in great part on the political will supporting the P3 program's objectives. For these reasons, P3 offices are more commonly located within the government, instead of outside the government framework as quasi-independent agencies.

Global Experience

At the global level, clearly the most popular location for P3 offices is in a government's Treasury Department or Ministry of Finance, as is the case with the South African, Indian, and Victorian P3 Units, amongst others. While not located within the Treasury, Partnerships UK has its roots in the Treasury and has Treasury representatives on its board.

While there are exceptions, international experience suggests that locating a centralized P3 office with a strong Ministry of Finance or Treasury is optimal. Treasury Departments and Ministries of Finance are powerful because of their control of government resources. They are thus endowed with automatic enforcement mechanisms (the ability to withhold funding). Ministries of Finance are not sector specific, thereby allowing for multi-sector management of P3 programs, and because they hold the purse strings, they automatically have credibility with other ministries.

Placing a P3 office within the Ministry of Finance or Treasury is also logical from a P3 program perspective. P3s are, by their nature, financial instruments and therefore need to be assessed in a more general framework. Line ministries have incentives to enter into P3s that provide infrastructure or services, but they are not equally incentivized to make sure that P3s are affordable for the government or offer the best value for money. Line ministries are also less focused on aspects such as contingent liabilities and risk allocation, because their primary focus is on service provision.

Certainly the Ministry of Finance and/or Treasury Department are not the only options. In some instances, countries have created stand-alone P3 entities, such as in the case of Canada. In others, P3 offices reside with procurement authorities, while still in others, they may be aligned with the Prime Minister's or President's office.

While the centralized P3 office's location is of the utmost importance, depending on that entity's functions, consideration may also need to be given as to the location of Project Development Facilities within executing agencies and budget organizations. Often a budget organization or agency will develop its own sector-specific P3 Project Development Facility or P3 office, instead of utilizing existing capabilities (i.e., procurement or contracting office).

U.S. Experience

Unlike other jurisdictions, the institutional structure around P3 in the United States has been (and is expected to continue to be) highly decentralized. In great part, this is due to the localized nature of U.S. infrastructure delivery decision.

Unquestionably, one of the best-known P3 offices in the United States resides at the national level within the Federal Highway Administration (FHWA). The FHWA established the Innovative Program Delivery (IPD) Office in October 2008 to provide a comprehensive set of tools and resources to assist the transportation community in exploring and implementing innovative strategies to deliver critical infrastructure programs and projects. Innovation was viewed as a method for overcoming resource constraints, addressing energy and environmental considerations, and promoting efficiencies in program delivery.

The IPD Office focuses principally on the following functions:

1. Revenue generation;
2. Procurement (e.g., public-private partnerships); and
3. Innovative finance.

IPD is an advisory office which provide best-practice guidance and technical assistance to state and local governments considering or pursuing innovative finance and delivery structures, such as P3. Given the success of this structure, now other federal agencies are at various stages of establishing similar offices, including the United States Army Corps of Engineers and the Bureau of Reclamation.

Likewise, state and local authorities have created both sector-specific and multi-sector P3 offices across the nation. Sector-specific P3 offices include Virginia Department of Transportation's Office of Public-Private-Partnerships, as well as the Pennsylvania Department of Transportation Public Private Partnerships Office, to name just a few. Examples of multi-sector offices include the District of Columbia's office of Public-Private-Partnerships (DCOP3) and the Texas Facility Commission Center for Alternative Finance and Procurement. In all cases, the role played by the P3 offices are tailored to meet the specific needs of relevant agencies and authorities.

Other Considerations

Staffing

Recent experience shows that most centralized P3 offices provide some common functions. First and foremost is technical assistance in both the Transaction Phase, as well as in the Partnership Phase, particularly when contracts fall into dispute. Likewise, most P3 offices have worked towards the standardization and dissemination of best practices. These realities confirm that a successful P3 program benefits from a highly specialized and multidisciplinary set of skills.

For this reason, significant attention should be given to the recruitment and selection of staff for the P3 office. In this regard, there is no single model that ensures that a P3 office will function adequately. In some instances, P3 offices carry out much of their own technical work in-house, while utilizing short term contracts to hire specialized consultants. In other cases, P3 offices work with long-term in-house consultants. Alternatively, some P3 offices out-source most of the work to private sector contractors. Staffing decisions, as well as wage levels, will depend in great part on local capacities.

Nevertheless, due to its multidisciplinary nature, a P3 office should be staffed by professionals with expertise in multiple competencies (law, finance, public relations, etc.). The ability of the P3 office to either directly fulfill its functions, or to serve as a competent counterpart to external advisors, depends in great part on the technical competencies of the permanent staff. Significant support should be given to the staff of the P3 office in order to build capacity and ensure that external advisory services contribute to the P3 program goals and objectives.

Sustainable Funding

In order to contribute to a successful P3 program, P3 offices require strong political support, clear authority, and adequate funding. Creating a sustainable funding source for the P3 office and the P3 program should be a high priority for policy makers, particularly in jurisdictions with new P3 programs, where technical expertise may be somewhat limited.

Funding should be provided to ensure that all tasks associated with the entire P3 life-cycle are adequately supported, including project development and contract governance, as well as broader P3 program management. The role of the P3 office in prioritizing and allocating P3 program funding should also be defined.

There is a broad array of funding options for P3 offices and P3 programs, ranging from direct budget allocations to more to complex performance-based mechanisms (i.e., transaction fees). Regardless of the funding source, P3 offices and P3 programs cannot be successful without adequate resources.

Technical Assistance to Structure P3 Offices

Public authorities should turn to experienced advisors to assist them in designing the appropriate institutional framework for their P3 program. Poorly designed P3 offices or ill-conceived organizational structures can threaten the viability of broader P3 initiatives and threaten transactions. External experts can ensure an objective assessment of institutional capabilities and should be able to draw on national and international experience to best align institutional structures to broader program objectives.

P3 Office Evolution & the Maturity Curve

Although significant attention has been given to the start-up and design of P3 offices, in reality, these specialized centers of expertise are dynamic and constantly evolving. Their role will change and adapt as the P3 program matures. The functions and responsibilities of centralized P3 office will need to be reinterpreted and revised to meet the changing needs and evolution of the P3 program.

While many P3 offices begin by disseminating best practices, coordinating policy, P3 promotion / marketing, and offering technical assistance in project implementation, their role tends to evolve as the P3 program advances. As jurisdictions progress along the P3 maturity curve, the centralized P3 office may reduce some or all of its executive functions, transferring greater transaction responsibility to agencies or budget organizations, while simultaneously assuming new and expanded responsibilities in other areas (i.e., quality control, contract enforcement, government support / guarantee priorities, and management of contingent liabilities). These new functions often require that P3 offices acquire new and expanded skill-sets in order to properly execute their additional responsibilities. For this reason, continuous training and capacity-building are required.

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