

COMPETITION, PARTNERSHIPS AND MONETIZATION OVERVIEW

Dr. Adrian Moore, Vice President,
Reason

Geoffrey Segal, Senior Fellow, Reason

Several thin, white, parallel lines of varying lengths and slopes are positioned on the right side of the slide, extending from the top right towards the bottom left.

Public-Private Partnerships (PPPs) Defined



- PPPs—a.k.a. privatization, contracting out, outsourcing, competitive sourcing, competitive tendering—is simply an arrangement (typically a contract) between governments and private sector entities (for-profits, nonprofits, volunteers) in the delivery of public services.
- Ranges from simple partnerships to large-scale asset sales and joint ventures; taps private capital in most powerful versions.
 - Corporate sponsorships; naming rights; volunteer initiatives
 - Service contracting; outsourcing; competitive sourcing
 - Infrastructure PPPs: combination of design, construction, financing and/or O&M in delivery of assets; leveraging capital
- PPPs are simply policy tools—they can be effective when used well and ineffective when used incorrectly.



Competition is Key to 21st Century Government



- Government's role is evolving from service provider to provider & broker of services
- Government has come to rely far more on networks of public, private and non-profit organizations
- PPPs now seen as a proven policy management tool to deliver better services at a lower cost
 - BUT, process is complex, requires care & best practices
- “[T]he fastest way to save money and increase value is to force public institutions to compete.” —David Osborne and Peter Hutchinson, *The Price of Government*



Common goals of PPPs

- **Cost Savings**
 - Capital costs, life-cycle operations, maintenance
- **Service/Quality Improvements**
 - Competitive bidding; performance guarantees
- **Innovation**
 - Tapping broader experience, Bringing new minds to bear on problem
 - Static processes, red tape obstacles to public sector innovation
- **Enhanced Risk Management**
 - Key risks (cost, delivery, liabilities) can be transferred from public to private sector
- **Accelerated Delivery**
 - Time is money, performance incentives
- **Deploying private capital to finance assets/services**
 - Highways/bridges, water/wastewater, university facilities, parking assets, etc.
 - Social impact bonds (aka social innovation funding) in recidivism, workforce

Where Can Governments Apply PPPs?



- Vehicle fleet operations, maintenance & ownership
- Core IT infrastructure & network, web & data processing
- Administrative support services (e.g., HR, payroll, accounting, mail, printing, etc.)
- Risk management (claims admin, loss prevention, etc.)
- Park operations & maintenance
- Road, building, facility maintenance
- K-12 education facilities (including financing), maintenance & non-instructional services
- Public transit operations, assets and system expansions
- Facilities financing, operations & maintenance
- Revenue-generating assets (parking assets, water/wastewater facilities, muni energy enterprises, etc.)
- Core infrastructure (roads/transit, water, airports, schools, etc.)

Where Can't States Apply Competition/Privatization?



- Virtually every service, function and activity has successfully been subjected to competition by a government somewhere around the world at some time.
- When asked what he wouldn't privatize, former Florida Governor Jeb Bush replied: *"...police functions, in general, would be the first thing to be careful about outsourcing or privatizing. This office. Offices of elected officials ... and major decision-making jobs that set policy would never be privatized."*
- Under Bush's watch, Florida used competitive sourcing more than 130 times, saving more than \$741 million in actual dollars and prevented an estimated \$1.4 billion in additional costs.

Common concerns:

“Privatization” = loss of control



- In well-structured PPP contracts the government and taxpayers *gain* control and accountability, rather than lose it.
 - Public sector retains ownership, rate control, regulatory control
 - Failure to meet the contractual performance standards could expose the contractor to financial penalties, termination of the contract
- Canadian Finance Minister Jim Flaherty:
 - *“Under the [proposed Regina] public-private partnership, the city will continue to own the infrastructure assets, as always. What’s more, the city will still continue to control sewer rates and have full power to ensure quality and safety standards are met.*

The private-sector involvement will be limited to the design, construction, operation and maintenance, along with paying for part of the plant.”

Common concerns: Risk transfer in PPPs



- Government entities often fail to acknowledge or value real risks that come with a price, especially with infrastructure projects.
 - Examples: cost overruns, schedule slips, deferred maintenance of assets
- U.S Government Accountability Office (2008):
 - *“The public sector may also potentially benefit from transferring or sharing risks with the private sector. These risks include project construction and schedule risks. Various government officials told us that because the private sector analyzes its costs, revenues, and risks throughout the life cycle of a project [...] it is able to accept large amounts of risk at the outset of a project, although the private sector prices all project risks and bases its final bid proposal, in part, on the level of risk involved.*

The transfer of construction cost and schedule risk to the private sector is especially important and valuable, given the incidence of cost and schedule overruns on public projects.”

Common concerns:

Public employee resistance



PPPs typically result in few, if any, layoffs.

- Many employees will shift from gov't to contractor; PPP agreements often include a requirement to hire some/all existing employees who meet minimal criteria.
- Typically wages and benefits go up for some employees and go down for others, and natural attrition accounts for most of the reduction in workforce.
- New opportunities for upward professional mobility when employees move to a firm managing a larger network of facilities.
- Techniques have emerged for involving employees in the planning process and investing in transition programs for employees that do not go to work for the contractor.

Common concerns:

Rising costs



- Because governments retain control over rates in PPP contracts, rates to customers are ultimately a *policy decision*.
- PPPs often bring small, steady rate increases over time in proportion to system needs and inflation; by contrast, governments often see large, step increases due to political pressures over rates.
- One 1999 study examined PPPs for water/wastewater systems in 29 U.S. cities serving over three million customers. It found that all resulted in lower initial & total rate increases than were planned prior to the PPP, and at 17 percent of the facilities, PPPs brought cost savings of between 10 percent and 40 percent, allowing local governments to avoid large increases in water rates.

ROLE OF THE GOVERNMENT AND PRIVATE SECTOR IN PPPS



► Public sector's key role is setting the agenda

- Specify desired outcome
- Controls terms of operation, including right to make future changes
- Maintains legal title to asset

► Private sector's role is setting the price

- Calculate financial impact of policy decisions
- Educate on concession model and how it addresses concerns
- Responsible for all expansion, maintenance, and operations costs
- Must comply with concession agreement
- Collects revenue

► Some key “dials” to consider

- Concession length
- Tolling schedule
- Non-compete clauses
- Revenue sharing
- Existing employees and labor agreements
- Condition of facility at end of concession



Key steps for success: Other best practices in PPPs



- Conduct business case/value-for-money analysis for projects to frame the option set; evaluate tradeoffs.
- Harness the strength of performance-based contracting.
- Develop performance metrics and goals, and build these goals and benchmarks into the contract.
- Tie vendor payment to performance; incentives and penalties.
- Develop strong oversight and monitoring and protocols before entering into a contract to ensure compliance.
- Government's role does not end with contract signing; rather, role shifts to rigorous monitoring and contract management.
- Communicate early and often with stakeholders, public, media

Key Steps for Success:

Some Global Best Practices in PPPs



- Establish PPP center of excellence to guide process, implementation; can be formal or informal
 - Central management, consolidated expertise
 - Enterprise-wide approach brings consistency
 - "Best value" selection
- Conduct business case/value-for-money (VfM) analysis for projects to frame the option set; evaluate tradeoffs
- Establish clear, predictable legal framework for PPPs
 - No legislative approval of PPP contracts (political risk)
 - Allow blending of public and private funds to finance projects
- In infrastructure, attract market interest with a project pipeline
 - Don't pursue PPP projects, build a PPP program
 - Broad scope will attract the most interest

BRINGING P3S TO MISSISSIPPI



1. **Creating a Central Office for Competition**
 2. **Competitive Sourcing**
 3. **Infrastructure Public Private Partnerships**
 4. **Monetization of Unneeded or Noncore Assets**
- 
- A series of several parallel white lines of varying thicknesses, slanted diagonally from the bottom left towards the top right, located in the lower right quadrant of the slide.

CREATING A CENTRAL OFFICE FOR COMPETITION



WHY A COMPETITION OFFICE?



- ▶ The most successful P3 programs have established a dedicated office and team to administer P3s
 - ▶ Outline objectives and goals
 - ▶ Consistent application across multiple projects
 - ▶ More effective public communication and education
 - ▶ Prioritize limited resources
 - ▶ Drive reform into how infrastructure is procured
 - ▶ Professionalize procurement
 - ▶ Develop institutional knowledge and “memory”
 - ▶ Standardized process
 - ▶ Reward and incentivize performance
 - ▶ Examples:
 - ▶ Florida CEG
 - ▶ Partnerships BC
 - ▶ Puerto Rico PPPA
 - ▶ OTPPP in Virginia



Case Study: Florida Council on Efficient Government



- Midway through his term, Gov. Bush's major privatization successes became overshadowed by media spotlight on a few big-ticket projects experiencing implementation challenges
- Gov. Bush: the state was *"not very good at procuring, and as a result we've had some challenges . . . that have clouded a really good record as it relates to saving money for the state...we have to get better at procuring and monitoring the procurements."*
- To that end, signed March 2004 executive order directing the Dept. of Management Services to create a "center of excellence" authorized to conduct a statewide evaluation of Florida's competitive sourcing efforts.

Case Study: Florida Council on Efficient Government



- CEG (subsequently codified into statute as the Council on Efficient Government) is Florida's enterprise-wide gateway for best business practices in competitive sourcing:
 - Trained unit that assists agencies with their competition initiatives, accountability, and communication
 - Developed statewide outsourcing standards applicable to any proposed competition initiative
 - Identifies competition opportunities
 - Assists agencies with business case development
 - Oversees execution of outsourcing projects
 - and standardizes how the state identifies opportunities, conducts competitions, and awards and manages contracts for government services.

Central Offices Often Key to Success



- The bottom line is that the most successful state competition programs have a central coordinating office of some type
- That office plays varying roles depending on the needs and culture of the state

COMPETITION,
OUTSOURCING,
COMPETITIVE
SOURCING



Competitive Sourcing

Allowing private organization of various types to compete with government workers to provide services, encouraging innovation in cost savings and service provision.



Require Regular Commercial Activity Inventories



- Scour all agencies, all services, all activities—classifies each as either “inherently governmental” or “commercial” in nature
- “Yellow Pages Test”: inventory helps government concentrate on delivering core, “inherently governmental” services while partnering with the private sector for commercial activities
- Virginia: 1999 inventory identified 205 commercial activities involving over 38,000 state employees (out of <90k)
- Get government out of the business of business—that’s what private businesses DO!

Federal Competitive Sourcing Results



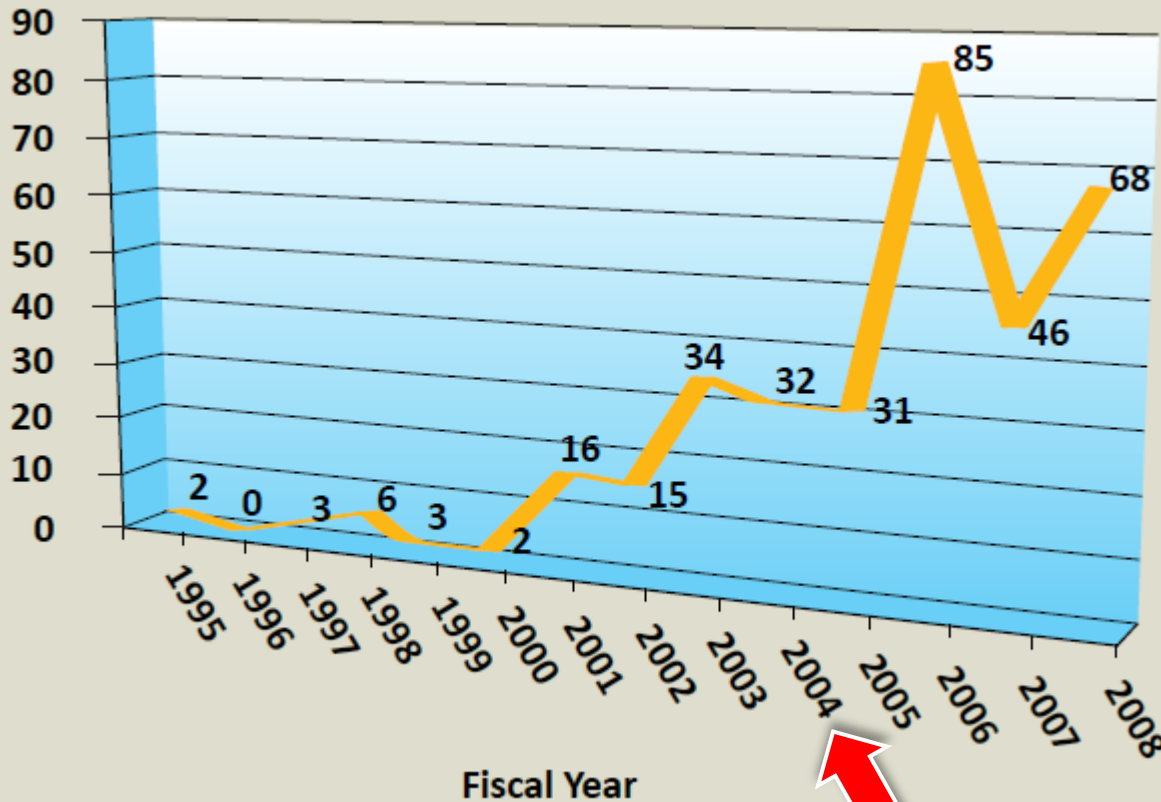
Federal government made extensive use of competitive sourcing until Pres. Obama suspended it in 2009.

- 1,375 competitions completed in FYs 2003 – 2007 estimated average savings of \$5.2 million per competition.
- All different sizes and shapes of competitions. Average size of government unit competing--38 personnel.
- Agencies paid modest investment costs for their high returns. Average costs for competitions \$175,000
- Realized savings increased over time benefiting both from experience and greater competition
- Government workers won 50-75% of competitions.

Change was unleashed by competition!

Florida State Contracting Skyrockets

Number of Outsourced Projects in FL, FY95-FY08



1999

<20 contracts

2008

551 contracts,
lifetime value of
over \$8 billion

25

Center for Efficient Government created

Making Florida's Government Compete



- Bush's initiatives included:
 - Highway maintenance
 - Core enterprise IT infrastructure
 - Vehicle fleet management
 - Medicaid billing
 - Toll collections
 - Online professional licensing
 - State psychiatric hospitals
 - Prison food service
 - Maintenance in state parks
 - Custodial services
 - Over 100 others!

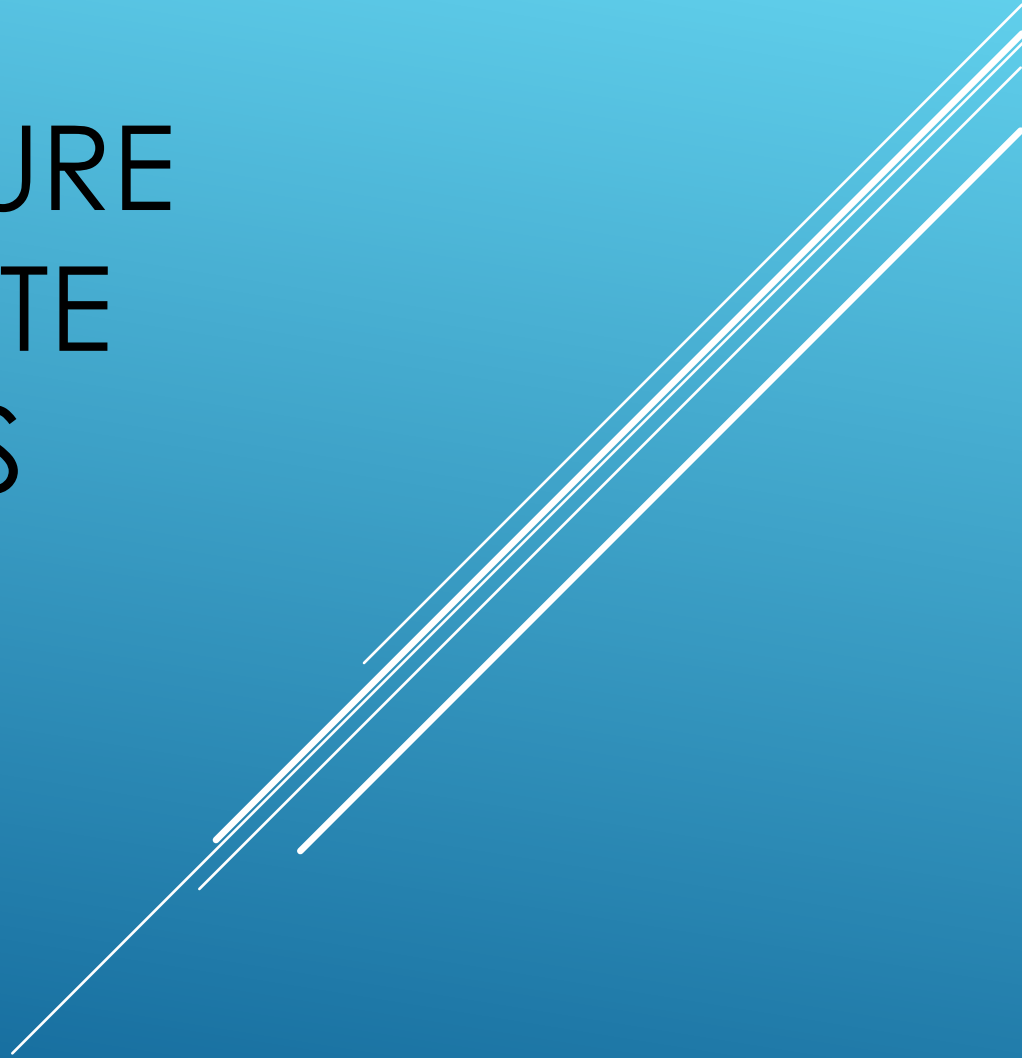
Initiative	Results
Prison Food Service	\$16.9 million over 3 years
Juvenile Justice Food Service	\$2.5 million annual
Medicaid Billing	\$1.7 million annual
Online Professional Licensing System	\$2.2 million to date
Data and Research Services	\$353,145 to date
Centralized State Park Reservations System	100 percent increase in reservations
Maintenance of State Parks	Reduced equipment repair costs, savings at more than \$650,000 a year
Employee Help Desk	Contract was cancelled
Highway Maintenance	\$83.7 million or 15.3 percent throughout the life of the contracts
Inmate Health Care	\$24.6 million over 4 years



THINGS TO CONSIDER

- ▶ Regular, rather than occasional, competition delivers the best results
- ▶ Public v Private cost comparison
 - ▶ Full cost accounting
- ▶ Structuring real contracts with government teams that win competitions
- ▶ Should Government have to prove itself to be more efficient to perform commercial activities?

INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS

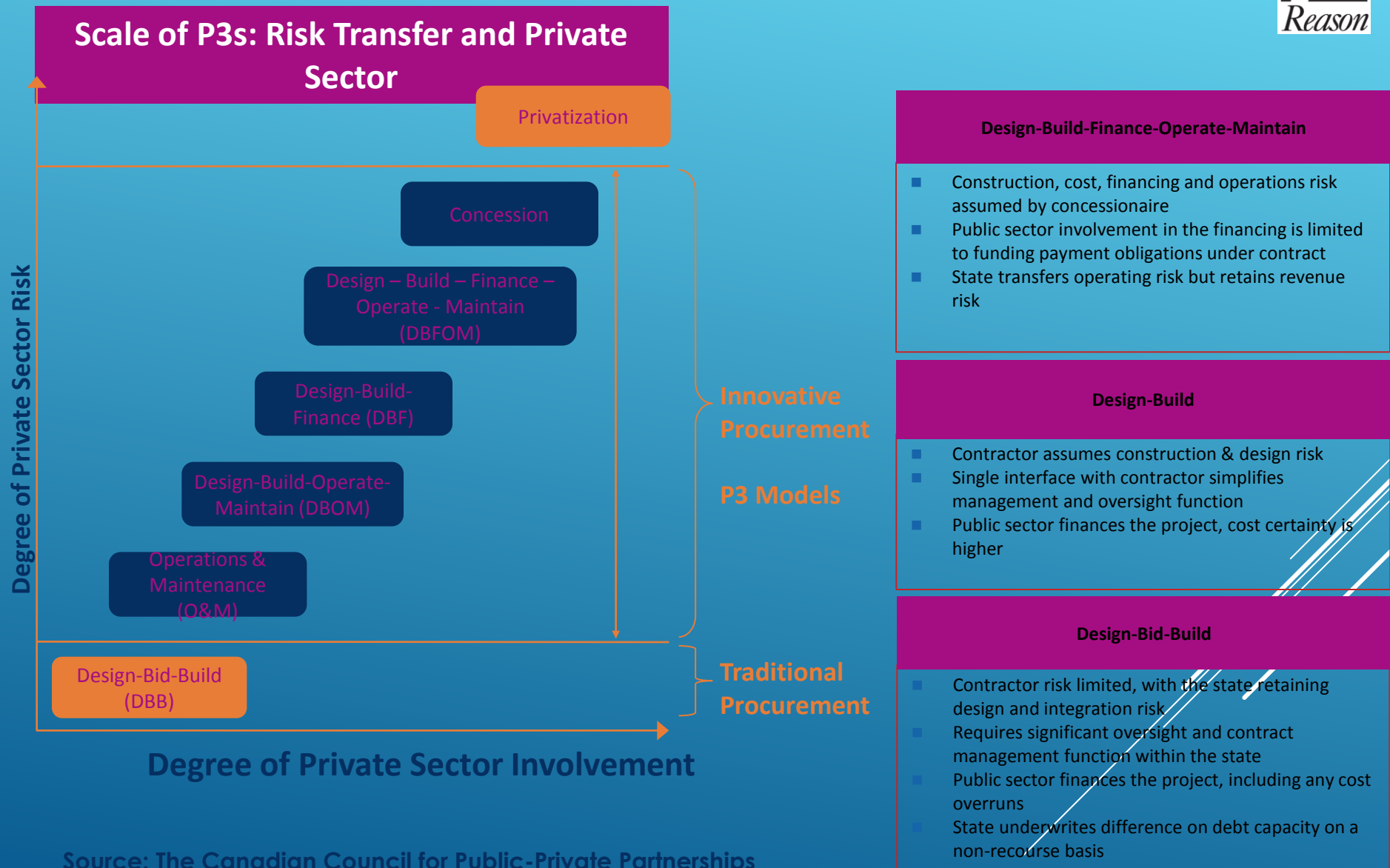


BRINGING INVESTMENT TO MISSISSIPPI



- ▶ “Airports to Wastewater”
- ▶ More capital than projects
 - ▶ \$30B of equity invested in transport alone in US
- ▶ Brings market discipline to infrastructure investment
 - ▶ Better project selection
 - ▶ Identify ideal scope
 - ▶ Efficiency and innovation in procurement process
- ▶ Better matches infrastructure needs and resources
- ▶ Eliminates procurement inefficiencies and gaming; drive public trust into procurement system
- ▶ Protection of public interest through concession agreement

PROCUREMENT OPTIONS



THE PUBLIC SECTOR RETAINS CONTROL



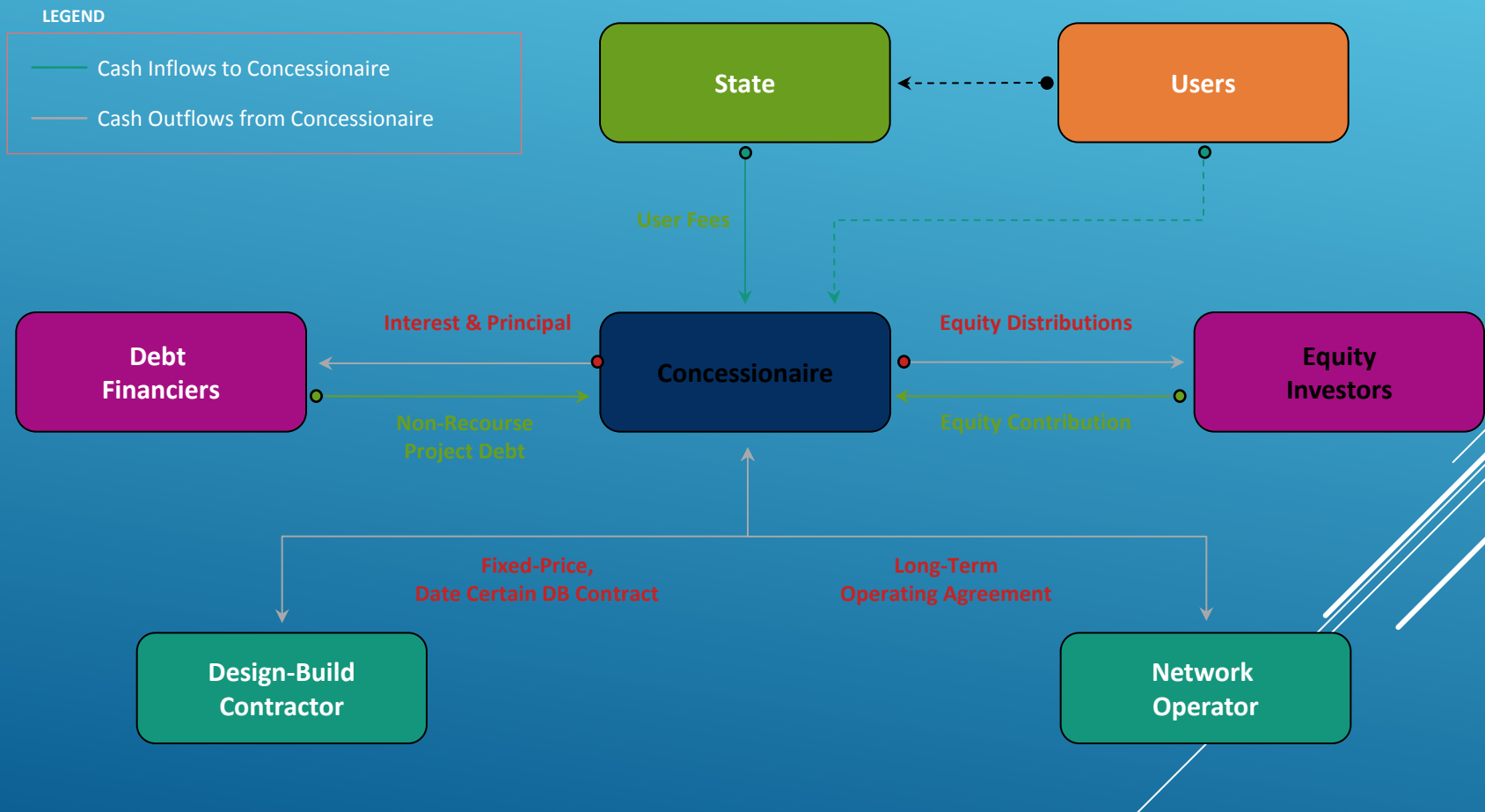
- ▶ Government customizes the partnership to achieve its objectives
- ▶ The key requirements, which are typically set out in a detailed concession agreement (often several hundred pages), include:

Public sector determines	Public sector determines performance requirements / standards	Public sector determines risks borne by private sector	Public sector determines enforcement penalties	Public sector determines how to use excess revenues
<ul style="list-style-type: none">● Concession length (number of years)● User fee level and growth (e.g., tolls)● Availability payment level and growth● What and how public pays for asset	<ul style="list-style-type: none">● Project specifications● Design and construction standards● Operating, maintenance and safety standards● DBE commitment	<ul style="list-style-type: none">● Traffic● Legal / revenue impacting facilities● Unexpected site conditions / hazardous materials	<ul style="list-style-type: none">● Penalties for underperformance, including provisions for early termination● Handback requirements	<ul style="list-style-type: none">● Lease payments by private sector● Revenue sharing● Refinancing gain sharing

TYPICAL P3 STRUCTURE



- ▶ Contractual structure reflects fixed nature of the cashflows, which minimizes lenders' risk exposure and permits a highly leveraged capital structure with an efficient cost of capital



AVAILABILITY PAYMENT OPTIONS

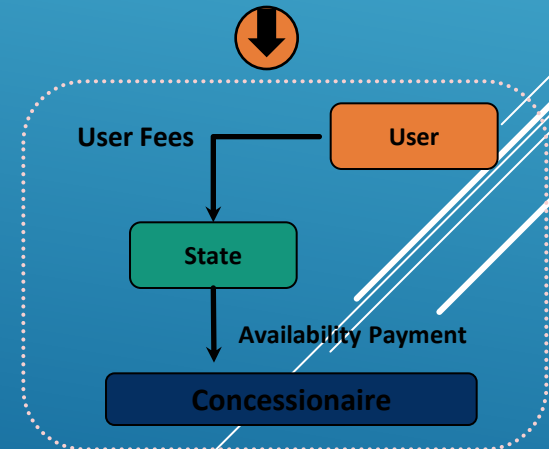
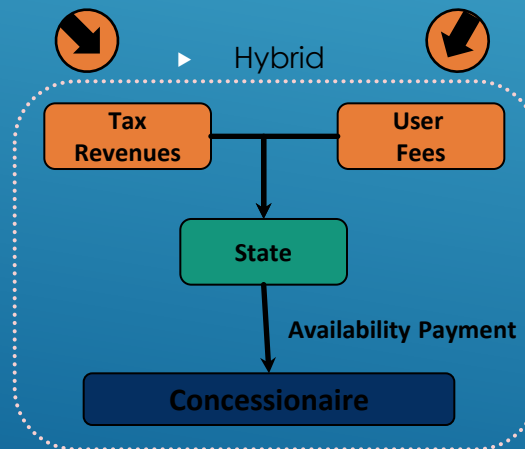
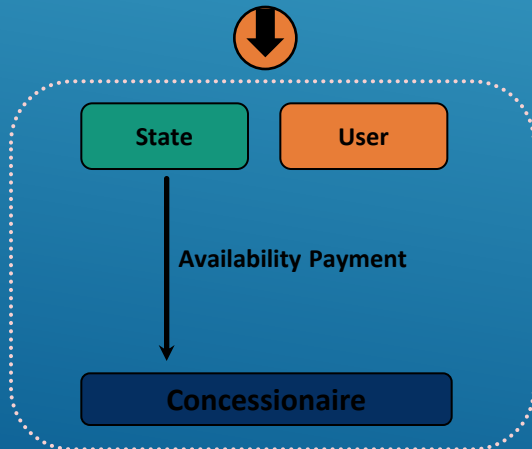


► Availability Payment

- State retains the demand risk
- Payments are funded from existing revenues / reserves
- Highly visible revenue stream allows Concessionaire to optimize capital structure
- Availability PPPs have achieved gearing ratios in excess of 90%
- Payments may be subject to appropriations risk

► User Charges

- User charge based on fee for service concept
- Fee paying users receive basic connectivity at no extra charge
- State has discretion on shaping the fee to user demographics
- For example, scaled to property taxes, multipliers for business, etc
- Relief options for indigent / elderly



DRIVERS AND GOALS OF PPPS



Risk Transfer To Private Sector



- PPPs can transfer design, construction, financing, revenue, operations and long-term maintenance and long-term rehabilitation risks to the private sector
- Private sector seeks to manage these risks effectively to maximize its return on invested capital
- Significant at risk capital ensures risk allocation sticks

Accelerated Project Delivery



- Availability of private capital can significantly accelerate project delivery
- Studies of PPPs vs. traditional public delivery in Australia and the UK show that 25% and 70% (respectively) of public sector projects finished behind time, whereas only 1.4% and 24% of PPP projects finished experienced time overruns
- In the US, private design-build contracts saved 14% in time over conventional procurement over a 3-year study period

Eliminate Cost Overruns



- In the US, both Denver FasTracks Eagle P3 and Port of Miami Tunnel P3 achieved 20 - 50% cost savings over their competitors
- US, over 12% of traditional procurements face cost overruns, whereas less than 1% of PPPs have³

Operational Efficiencies



- Private partner brings global best practices in operations, maintenance and customer service delivery (including new technologies) based upon experience across portfolio of assets
- Private partner has a financial incentive to provide consistent and high quality service to the public

Innovation



- Far more experienced

Common goals of PPPs



- Guaranteed annual operating budgets and costs
- Guaranteed system operations, regulatory compliance, service quality
- Guaranteed construction costs and facility start-up schedules
- Guaranteed customer service and response
- Guaranteed revenues and revenue collection



INFRASTRUCTURE P3 EXAMPLES

▶ California

- ▶ UC Merced Master Development; Long Beach Courthouse; Long Beach Civic Center

▶ Colorado

- ▶ US-36 Managed Lanes; Central 70 Redevelopment; RTD Gold Line

▶ Florida

- ▶ Port of Miami Tunnel I-4 “Ultimate”

▶ Georgia

- ▶ University Housing

▶ New York/New Jersey

- ▶ Goethals Bridge; LGA Central Terminal Redevelopment

▶ Texas

- ▶ LBJ Expressway

▶ Virginia

- ▶ Elizabeth River Crossings; Capital Beltway HOT Lanes

MONETIZATION OF UNNEEDED OR NONCORE ASSETS



Understanding what you own and what you need.



- Build and use real property inventories to actively manage asset/real estate holdings.
 - Knowing what you own: inventory is a central record of government-owned land and assets built within a geographic information system; ties maps and asset data.
 - Facilitates better asset management and divestiture opportunities
 - Georgia: 2005 executive order for statewide inventory & admin support; state created *realpropertiesgeorgia.org*; by 2010 had sold off \$43.2M in surplus property; saved \$8.5M through renegotiated asset leases.

Understanding what you own and what you need.



- One 2011 GAO report looking at just some federal agencies identified over 45,000 underutilized federal buildings costing taxpayers \$1.6 billion per year to operate
- State inventories have identified buildings, houses, vacant land, golf courses, heavy equipment, warehoused goods, maintenance inventories, and other unused assets.

Divest non-core government assets

- **Asset sales and leases can right-size asset holdings; generate revenue; lower maintenance costs and long term capital costs.**
- **Ohio State University**
 - **Leased parking, generating \$483M payment**
 - **Student scholarships, improvements to bus service, hire tenured faculty**
- **State of Indiana**
 - **Leased toll road, generating \$3.85B payment**
 - **Fully funded highway program**
- **Virtually every non-core asset has successfully been divested somewhere**

Asset Monetization Best Practices



- Know what you own: Managing real property holdings is not a core competency of most governments. Unique agency systems and lack of central inventory or coordination are common. A government that doesn't know what it owns cannot hope to manage its assets in a cost-effective and efficient way.
- Each asset is unique: No cookie-cutter solutions to government asset transactions. Approach needs to match types of assets and needs of state. Sometimes outright sales, sometimes long-term lease agreements or concessions
- Retain expert consultants for due diligence and transaction guidance: In-house legal and financial experts in governments rarely have significant experience conducting complex asset sale or lease transactions
- Maximize competition and transparency in asset sales and lease procurements: Seek a a broad pool of bidders and avoiding sole-source deals. Robust competition will maximize asset values and revenue

QUESTIONS?

Adrian Moore

Adrian.Moore@Reason.org

Geoff Segal

Geoff.Segal@Reason.org