T2 Explainer: What is a Public-Private Partnership?

The Transportation Transformation Group is an unprecedented alliance of state government, finance, academic and private industry leaders who aspire to transform American transportation policy into a goal-based arrangement that maximizes flexibility to enhance the roles of the state and local public sectors and their private partners to solve the growing problems of congestion and mobility.

T2 publishes explainers to help policy makers and the public understand concepts essential to transportation transformation.

Public-Private Partnerships (PPPs or P3s) are collaborations between governments and private companies that aim to improve public services and infrastructure in a manner that capture the benefits of private sector involvement (such as cost- and time-savings) while maintaining public accountability.

While PPPs can take a variety of forms, in transportation, long-term PPPs are increasingly being considered for new road construction and modernizing existing roadways. These PPPs involve a private company investing risk capital to design, finance, construct, operate, and maintain a roadway for a specific term during which it collects toll revenues from the users or a stream of contract payments from the public agency. The public agency oversees all aspects of the agreement, from maintenance to setting toll rates. In some cases the private toll company pays the public agency an upfront fee for the contract, and in others the public and private partners share in the revenue generated by the road. For some projects where toll revenues do not completely support the capital needed, the public owner contributes government funds for a portion of the capital costs. When the contract expires, the government can negotiate a new arrangement or take over the facility at no cost.

PPPs are not a solution that can be applied to every problem in all situations. Even the most ardent PPP proponents acknowledge that they can address about 15 percent of our highway and bridge needs. With the existing gap between available public resources and funding needs, federal and state governments and local tolling authorities are looking at every possible solution to build the improvements needed by the public.

What are the benefits to state governments? PPPs are an effective way of financing, managing and operating roads while minimizing taxpayer costs and risks. Governments across the country and around the world are seeking ways to finance much-needed infrastructure projects and trying to deliver better services to taxpayers. Public-private partnerships maximize the strengths of both the public and private sectors, offering taxpayers more efficiency, accountability, and cost- and time-savings. PPPs can be used to build roads and highway projects that may have been delayed or shelved altogether due to fiscal constraints.

In fact, the major highway-funding shortfall is a key reason governments are increasingly turning to long-term PPPs to deliver new transportation projects. A Federal Highway Administration report estimated that the annual capital investment in our highways totals $68 billion, which is $6 billion less than what's needed simply to properly maintain the condition of our highways and bridges.

Moreover, an additional $51 billion per year would be needed to improve and expand the highway network just to keep up with the increasing demand for auto and truck travel. The existing state and federal fuel tax and highway trust fund system is unable to meet these investment needs. So increasingly, states are turning to toll finance and PPPs to begin to fill the funding gap.

How common are public-private partnerships in the transportation world? PPPs for complex, multi-billion dollar transportation projects have been used for decades in Europe, and more recently in Australia and Latin America. During the 1990s they began to be used in the United States and Canada as well. PPP toll projects are in operation in California, Texas, Virginia, Illinois and Indiana, under construction in Florida and Colorado, and in procurement in Georgia. Large transportation PPPs in excess of $1 billion are in operation or under construction in Melbourne, Sydney, Paris, Israel, Santiago, and Toronto.

What is a long-term concession? Concessions are long-term agreements under which the private developer designs, finances, constructs, operates and maintains a transportation facility for anywhere from 30 to 99 years.

How does a long-term concession PPP work? In exchange for the grant of the long term arrangement, an investor-owned company will finance, design, build, operate, modernize, and maintain a highway project, financing its expenditures from the toll revenues it is allowed to charge or from a stream of payments – called availability payments – from the public owner. However, the state or local government still owns the roadway and protects the public interest through negotiating and enforcing the terms of the concession contract. The company must adhere to all applicable laws, permit requirements and the contract terms.

Essentially this model extends the investor-owned utility concept from network industries like electricity and telecommunications to highways. Just as those industries are vital to the public interest, so too are highways.

Are there other ways of involving private enterprise in toll roads without large upfront payments to governments and nothing for taxpayers beyond that? The public owner has flexibility in how it negotiates the payments. Texas and Virginia have both negotiated long-term leases that provide for a smaller upfront payment but an increasing profit share beyond a set rate of return. In Europe, concession agreements have been crafted that provide annual payments with no upfront fee.

In Australia, the bidding on one particular project was not based on the size of the concession fee but on the lowest toll rates. For a state entering into a concession deal, there are two key trade-offs between upfront payment versus ongoing lease revenues over the life of the agreement: (1) current capital needs versus long-term needs, and (2) a "sure thing" (upfront payment) versus some risk as to what future revenues may be. There is no right answer; each state must weigh the trade-offs involved with each individual project.

Regardless of how the state is paid for the concession, when it involves the construction of a new roadway, the taxpayers gain a state-owned asset that can continue to provide mobility and generate revenue long after the lease term.

The vast majority of potential PPP projects in the U.S. today will not have toll revenues robust enough to generate a large up front concession payment. Instead, tolls can significantly lower, but not eliminate, the need for public funds to cover the project's capital costs. Thus, the policy challenge is not whether to charge a large up front payment or to share in revenues over time; rather, it is to maximize up front capital formation from non-public sources in order to leverage increasingly scarce public transportation dollars.

Next week: How TIFIA Help Solve Our Problem

T2 is happy to exchange ideas about this or any other matter related to the next surface transportation bill. Contact Billy Moore at (202) 288-0892 to set up a discussion. You can also get additional information at our website www.trans2group.com