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CONSTRUCTION

TO P3 OR NOT TO P3, THAT IS THE QUESTION . . .

P3 BACKGROUND

On April 1, 2013, President Obama called for a “Partnership to Rebuild America,” $21 billion in public- and private- sector investment in roads, bridges, and other infrastructure projects. This was against a backdrop of an increasing appreciation of the aspirations and perceived benefits of utilizing a Public-Private Partnership (PPP or P3) model in the United States. P3 arrangements consist of contractual relationships established between governmental organizations and private sector providers for the purpose of developing capital assets and operational services for infrastructure projects such as roads, bridges, ports, social real estate, hospitals, and schools. Currently a limited number of states, such as California and Florida, have become major proponents of this project delivery model. However, successful P3 implementation on a number of projects has sparked interest that is growing rapidly in the U.S. More than 30 states have enacted statutes that enable the use of the P3 model with the aim of attracting private investment in public infrastructure, alongside use of their expertise and innovation in project delivery.

P3 as a project delivery method can be seen to sit within a wide range of partnering options previously developed for the benefit of the public sector, ranging from simple design-bid-build to full outsourcing, in which P3 may be described as one of the more complex and immersive forms of partnering available. In Europe, Australia, and Canada, the P3 model has become synonymous with the provision of private finance alongside the private sector input into design, build, and operation of an asset, commonly known as a Private Finance Initiative. Since such arrangements embrace a high degree of support from the private sector, they require the development of intricate and robust contract structures and financial arrangements to ensure the success of P3 ventures.

The key attraction of the P3 model is the ability to transfer risk and responsibility for the financing and development of a public capital asset over to the private sector, where there is a perception that the private sector is better placed to control the development risks and is suitably financed for a return on the investment.

However, this model has not been without some criticism in instances where projects have not been perceived to achieve the required outcomes for the end users and taxpayers in terms of the quality of service received and/or financial premium obtained by the private sector funding the project. One of the component factors that can lead to this outcome is the fact that such partnerships are established for a significant period of time, usually in the region of 25 to 30 years, so a number of challenges and risks can arise during the life time of such a project. Crucially for the public sector as the initiator of such an arrangement, the proposed partnership needs to be perceived to represent the best "value for money" from the outset.

CONSIDERING A P3 STRATEGY

Before embarking on the use of P3, it is essential that a strategic decision is taken to proceed with a project based on a robust business case appraisal of the relative merits, and costs and alternative procurement options. In order to achieve this, a procuring governmental body needs to give serious consideration to establishing the required governance structure that includes political and stakeholder support, as well as management resources, to undertake the appraisal and carry the project forward into development. Projects often fail if there are insufficient resources available, one of the many consequences of waning support.

In the United Kingdom and Australia, many successful P3 projects have elected to adopt or have mandated best-practice techniques to develop the appropriate governance. One of these management reporting mechanisms is the PRINCE2 (Projects in a Controlled Environment, Version 2) methodology developed by the UK Office of Government Commerce. This is a process-driven methodology that focuses on the required project outcomes and is based on the development of projects coupled with the necessary resources and techniques required to keep projects on track. Alternative leadership and project management processes and procedures can be utilized, such as the Project Management Body of Knowledge Guide and aspects of Six Sigma. However, irrespective of the approach taken, the heart of the project strategy needs to include the development of a robust business case that can be reviewed and updated at key decision points during the project development.

This business case approach is a common feature to P3 projects since it is intended to support the proposed P3 delivery strategy as representing the best value for money solution through an objective, unbiased assessment of the financial and other tangible benefits over alternative options. As mentioned previously, the establishment of a P3 contract is for a significant duration, which therefore requires development and comparison of a range of long-term investment decisions for P3 against the alternative procurement options of a project via conventional procurement and operational methods, or the alternative partnering arrangements. An assessment needs to be made of the respective merits and disadvantages of each procurement route in the form of a qualitative assessment, together with a quantitative assessment of the financial profiles for each option, incorporating potential financial risks and opportunities that may arise with each option. A final assessment draws together the qualitative benefits achieved along with the quantitative financial input to determine which option is anticipated to be the most cost-effective and thus represent the best value for money.

A business case also needs to stand up to independent scrutiny, and consider and adopt at least some recommendations and constructive criticism to make it more robust. For example, a recent report issued in July 2013 by the Commission of Inquiry regarding the plan for the Yonkers School District P3 project raised a number of concerns that were not directly critical of the P3 model but highlighted a range of flaws in the financial assumptions and suggested alternative financial projections. In this situation, it is possible to have some sympathy because determining the appropriate levels for financial variables, such as inflation levels and the cost of borrowing, over a long duration, becomes increasingly subjective given their propensity for change.

A method of going some way to address this problem is to implement financial modeling techniques that take into account a range of different financial variables, such as assumed inflation levels or the cost of borrowing, by assessing a range of possible best-case and worst-case figures. This can be applied using risk management techniques such as “Monte Carlo” simulation to determine the range of potential outcomes. This can provide greater confidence in the quantitative assessment of the different options. Where it is found that particular financial variables are more sensitive than others, resulting in a greater impact on the success or failure of the project, it presents an opportunity to reconsider whether the public or the private sector is better equipped to retain or transfer responsibility, given differing financial conditions. Such considerations should be determined through initial market soundings with prospective private sector partners to establish their appetite to take on such risks before the project proceeds.

ESTABLISHING A P3 PROJECT

Experience shows that for a P3 project to be successful, the public owner must have strong leadership and project management skills to get the project off the ground even before it enters into a procurement phase with the private sector. In addition, the public owner needs to partner with a variety of technical and financial specialists to appraise the alternative procurement options for the design, construction, operation, and financing of a capital asset. Further, the public owner’s team should include a legal specialist to determine the commercial and contractual viability and implications of such a complex partnering arrangement. These resources will also be required should the project advance into the procurement phase with the development of the contractual, technical, and financial requirements for a Request for Qualifications or Request for Proposals from the private sector and in turn support the procuring governmental body in the review and negotiation of the responses.

Therefore, a public owner will need to secure a range of internal and external resources equipped with the necessary project management skills, and legal, technical, and financial expertise. However, it should not be forgotten that these resources need to be effectively and efficiently deployed within a transparent and accountable business case framework with appropriate leadership and governance to steer the project to success.

Navigant has been at the forefront of Public-Private Partnership deals since the inception of P3 in the UK during the 1990s and as P3 continues to evolve in the U.S., Canada and worldwide. Navigant, through its Global Construction Assets and Infrastructure Advisory Practice, provides a full range of integrated project management, technical and financial infrastructure services, along with complementary services from our Disputes & Investigations and Valuation & Financial Risk Management Practices to form a truly crosspractice collaborative approach.

Mike Yarwood is a Director in the Asset and Infrastructure Advisory Practice at Navigant Consulting, Inc. He can be contacted on +44 (0) 7920 445254 or by email: mike.yarwood@navigant.com.technical skills in working with complex discovery matters.

CONTACT

MICHAEL P. YARWOOD
Director
Navigant

navigant.com

About Navigant

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