

**A GUIDE TO UNDERSTANDING
AND EVALUATING THE USE OF**

Public-Private Partnerships for Public Buildings

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While public-private partnerships (known as “P3s”) have primarily been used in the U.S. for transportation and water projects, the model has recently been touted as a way to address infrastructure needs to repair, replace, or build new public buildings. Public buildings are where government operations take place. This includes buildings with office space for the operation of federal, state, and local agencies, courthouses, jail and prison facilities, airport terminals, public school buildings, and public university buildings, such as lecture halls and dorms. This category of infrastructure is sometimes called “social infrastructure.” Many public buildings are in need of major maintenance or replacement. For example, the American Society of Civil Engineers rated 24 percent of public K-12 schools as being in fair or poor condition, and found that 53 percent are in need of rehabilitation. This translates to an estimated \$38 billion annual funding gap.¹

To help fill this gap, some local and state governments are considering P3s that use private capital to finance public projects. In the U.S., using P3s for constructing public buildings is relatively new. Some types of government buildings, such as courthouses and higher education facilities have recently been constructed using a P3 model. However, for other types of buildings, such as public K-12 school buildings, no P3 transactions have been completed to date. However, evaluating P3 projects in other sectors, such as transportation and water infrastructure, and the experiences of other countries that have completed P3 projects in the “social infrastructure” category, such as Canada, is instructive. Numerous case studies show that inserting private interests into the development and maintenance of public infrastructure has proven to be difficult and even counterproductive when equity considerations and standards aren’t included, and adequate care isn’t taken to protect the public interest.

This guide aims to help advocates, policymakers, and other stakeholders better understand and analyze public building P3 proposals, contracts, and related legislation. We describe critical issues and include key questions stakeholders can raise to ensure that a given project advances the public good. While this is not an exhaustive list of questions, it provides a useful framework to examine P3 deals involving public buildings.

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WHAT ARE PUBLIC-PRIVATE PARTNERSHIPS?

“Public-private partnership” or “P3” is an imprecise term that refers to different types of contractual arrangements between a governmental entity and a private entity. For the rehabilitation of existing public buildings or the construction of new public buildings, a P3 typically refers to some version of the following deal structures, which can last decades, typically between 20 and 50 years.

¹ American Society of Civil Engineers, “2017 Infrastructure Report Card – Schools.” <https://www.infrastructurereportcard.org/cat-item/schools/>

In the contractual agreement, the private entity agrees to design, build, finance, operate, and/or maintain a public building. In many cases, the governmental entity pays the private entity regular lease payments or payments called availability payments. For some buildings, such as a dormitory at a public university, the private entity may be repaid through the right to collect rent payments directly from students, instead of lease or availability payments. Additionally, the governmental entity may confer development rights onto the private entity, allowing it to develop adjoining public lands or operate private enterprises within the public building and collect those revenue streams as another source of long-term payment. The private entity can receive development rights in conjunction with regular lease payments, availability payments, or user-based rent payments.

For more information about availability payments, please see In the Public Interest's publication: *Availability Payments in Public-Private Partnerships: Issues and Implications*.



RISKS OF P3S FOR PUBLIC BUILDINGS

While P3s have received much attention as a way to combat our country's infrastructure woes, they are no panacea. A closer examination raises issues that warrant careful consideration for decision makers looking to undertake a P3 for public building(s).

LOSS OF PUBLIC CONTROL OVER POLICY AND PLANNING DECISIONS



In P3 arrangements for public buildings, some contracts may contain clauses that incentivize or require actions contrary to the public interest, or that limit the government's ability to make policy and planning decisions often decades into the future due to the long length of P3 contracts. These clauses may guarantee corporate profits by insulating the company from risks. While no school district in the U.S. has yet to complete a P3 project, Canadian provinces have experimented with this approach. For example, in 2007, Alberta signed a P3 to build 18 schools. Not only did costs eventually triple from the original estimated budget, but the contract also strictly limited access to the new school facilities. Community groups couldn't use the schools after hours for activities like child care and sports leagues.² In Saskatchewan, where the Canadian province has experimented with P3s for school buildings, P3 contracts have limited teachers from using classroom walls to post student work, decorations, and other materials. A staff guide instructs teachers to treat the facilities as "leased spaces."³

INCREASED COSTS TO PUBLIC BUDGETS



P3 arrangements can be more expensive for governmental entities when compared to traditional finance and delivery methods. One important difference between availability payments and government bonds is the cost of capital. Private equity financing is significantly more expensive than traditional tax-exempt municipal financing, and a portion of an availability payment is allocated for returns for investors. In 2013, the state courthouse in Long Beach, California, was the first major public building constructed using the P3 method. This P3 arrangement proved to be very costly, costing Californians \$53 million annually for 35 years.⁴ The California Legislative Analyst's Office estimated that the project may have been as much as \$160 million more expensive because the city used a P3.⁵ Because of the considerable expense, other state courthouses may not be able to be

² Canadian Union of Public Employees 737, "Keep Manitoba Public: Why P3s are the wrong director for our schools." https://cupe.mb.ca/files/2018/03/Backgroundunder_P3_schools_2018_02_08.pdf

³ Ibid.

⁴ "Judges say high cost of Long Beach courthouse is depriving other areas of courtrooms," Long Beach Press Telegram, May 18, 2016. <https://www.presselegram.com/2016/05/28/judges-say-high-cost-of-long-beach-courthouse-is-depriving-other-areas-of-courtrooms/>

⁵ California Legislative Analyst's Office, "Maximizing State Benefits From Public-Private Partnerships," November 8, 2012. https://lao.ca.gov/reports/2012/trns/partnerships/P3_110712.aspx

built. As Sacramento-based Superior Court Judge Steve White explained in 2016, the Long Beach courthouse came “at a cost so exorbitant that it has resulted in many counties needing courts and not getting them.”⁶

CUTTING CORNERS



In an effort to contain costs and maximize profits, private entities may skimp on quality of materials, quality of building maintenance, number of workers, and other important inputs. For example, school administrators in Edmonton, Canada, experienced problems with the private entity in a P3 contract not responding to maintenance requests in a timely manner, in effect forcing school board employees to perform the work. Moreover, important systems, such as electrical systems, experienced issues from the beginning. The contractor’s work failed inspection and school board staff ended up making repairs. The local school board ended up paying twice to get the work done right and on time.⁷ It is important to note that proponents often claim that P3s are superior because they ensure that the building is properly maintained for the life of the contract. However, long-term planning and financial commitment by the governmental entity can ensure that the building is publicly maintained over its lifetime without utilizing a P3 model, while allowing for greater public control over maintenance standards and responding to problems that occur. In other words, the governmental entity can simply commit to and budget for maintaining the building with public employees.

REDUCED LABOR STANDARDS



Cost savings often derive, at least in part, from reduced wages and benefits for construction workers who build infrastructure and workers who operate and maintain public assets. In a P3, permanent operations and maintenance workers are often private sector workers with lower wages and less health and pension benefits than their public sector counterparts.

LOSS OF TRANSPARENCY AND PUBLIC INPUT



Many P3 projects are marked by scant transparency and proceed with little or no opportunities for public input, including input by the communities most impacted by the new infrastructure.

While this is a general overview of issues, it should be noted that there are unique issues concerning P3s in each type of public building. In the Public Interest published a deep dive into the problems with P3s used to build jails and prisons. For more information, please see our report, *An examination of private financing for correctional and immigration detention facilities*.

Additionally, many of these general issues are present in P3s in the transportation and water sectors. In the Public Interest has published two guides that examine these issues: *Understanding and Evaluating Infrastructure Public-Private Partnerships (P3s)* and *Understanding and Evaluating Infrastructure Public-Private Partnerships in the Water Sector*.



⁶ “Judges say high cost of Long Beach courthouse is depriving other areas of courtrooms,” Long Beach Press Telegram, May 18, 2016. <https://www.presstelegram.com/2016/05/28/judges-say-high-cost-of-long-beach-courthouse-is-depriving-other-areas-of-courtrooms/>

⁷ Canadian Union of Public Employees, “Case study: Alberta P3 schools,” July 18, 2014. <https://cupe.ca/node/33119>

WHAT ISSUES DO P3S RAISE?

Below is a list of questions that identify key issues in proposed privatization deals involving public buildings. This is not a complete and exhaustive list, but the questions provide a framework for evaluating proposals for the potential privatization of a public building.



CURRENT STATE OF THE PUBLIC BUILDING, CURRENT AND FUTURE NEEDS AND ISSUES

- ▶ How does the public building, if there is one, currently meet community needs? Is it able to provide the space to successfully provide the public service or program?
- ▶ Are there problems with the current public building, if there is one? Has there been a thorough analysis of these issues, including causes of the issues and possible solutions? Potential issues to examine include:
 - Are there maintenance needs and/or additions to the public building that need to be addressed?
 - Is the public building accessible to workers, residents, students, the public, or other users?
 - Does the public building provide a healthy environment without the presence of dangerous toxins, molds, etc., that can endanger human health?
 - Is the public building resilient to natural disasters, climate change, and other changing environmental conditions?
 - What is the demographic make-up of the workforce that operates the public building? For example, does the workforce represent the diversity of the community?
- ▶ What problem(s) does the proposed privatization seek to solve? Has there been an analysis of how the governmental entity can address these problems without privatization?



CURRENT AND POTENTIAL FUNDING AND FINANCING

- ▶ Has an analysis been done to understand capital needs for the rehabilitation or construction of the public building?
- ▶ Is there a thorough understanding of the governmental entity's financial position and ability to take on new debt via municipal bonding, given the governmental entities' current bond rating and current debt load? Are there problems with the governmental entity accessing tax-free municipal bonds as a source of financing for the proposed project? Tax-free municipal bonds are a much cheaper source of financing than private equity financing, which can have an interest rate three to five times higher than traditional municipal bond financing.
- ▶ What other governmental funding and financing streams can be used to meet capital needs?
- ▶ Does the private entity have the financial capability to adequately maintain the public building and/or finance necessary improvements?



TO P3 OR NOT TO P3 – COMPARING OPTIONS AND CONTRACTUAL CONSIDERATIONS

- ▶ Has the governmental entity prepared an economic analysis describing potential revenues and expenses if the asset remained in public hands? The analysis should account for any anticipated improvements to the public building that would increase efficiencies, decrease maintenance costs, etc.
- ▶ Has the governmental entity performed or retained an outside firm for an analysis of various procurement options? In design, build, finance, operate, and maintain (DBFOM) projects, governmental entities rely on a Value for Money (VfM) analysis to compare lifecycle costs of designing, building, financing, operating, and maintaining an asset when using various procurement methods. A VfM analysis typically compares traditional procurement such as design bid build (DBB) or design build (DB) to a procurement approach with greater private sector involvement, such as a DBFOM.
- ▶ What are the specific assumptions in the VfM regarding cost savings and could they impact quality of service or workforce compensation, or inhibit public policy options? Methodology can dramatically alter the results of the VfM analysis. It may be necessary to get outside expertise to review the VfM analysis, including the assumptions used, identified risk factors, and calculation details. For example:
 - Are there assumptions about differences in cost of maintenance or operations workforce between the traditional procurement and P3 models?
 - Are there assumptions around maintenance of the asset between the traditional procurement and P3 models? Some VfMs assume that the government entity will not adequately maintain the asset and use this assumption in their financial analysis. But long-term planning and financial commitment by the governmental entity to publicly maintain the asset may result in lower costs than privatized maintenance.
- ▶ If the governmental entity must use private financing, has it considered the option of using direct public employees for some or all of the maintenance and operation of the building instead of outsourcing these functions as part of the contract?
- ▶ Does any cost analysis/comparison consider non-financial public interest criteria including social and economic impacts; accessibility of the infrastructure to low income communities; job quality; environmental impacts; and accountability and transparency measures?



IMPACTS ON THE GOVERNMENT'S BUDGET

- ▶ How will the governmental entity compensate the private entity in the proposed P3? Will the governmental entity provide regular lease or availability payments to the private entity? Will the governmental entity confer development rights onto the private entity and allow them to generate revenue from the resulting development? Will there be other payment mechanisms and/or a hybrid approach of more than one compensation scheme?
- ▶ What are the estimated annual payments that the governmental entity will have to pay? How does the availability payment formula work? Are there provisions in the contract that allow for this payment to rise?
- ▶ How does the governmental entity plan to ensure timely payment of the availability payment? What sources of funds will be used for repayment and how will this be accounted for in the budget for the life of the contract?
- ▶ Are there any anticipated or even somewhat likely events that could cause challenges to the governmental entity making the availability payments at any point in the long-term contract period?

- ▶ What are the transaction costs that the governmental entity will incur with a P3 approach, such as costs associated with the procurement process and oversight of the contractor for the life of the contract? Are these costs accounted for in the cost comparison/analysis?
- ▶ Will the governmental entity incur hidden costs with a P3 approach? For example, private sector maintenance jobs associated with the privatized public building that pay low wages or fail to provide health insurance benefits may result in an increase to another part of a governmental entity's budget, as the need for social safety net services will increase.
- ▶ Does the existing public building currently provide revenue to the governmental entity? If the asset currently provides net revenue to the budget, how will that revenue be replaced?
- ▶ How will the proposed privatization deal impact the governmental entity's bond rating? Are there risk factors associated with the deal that could impact the governmental entity's future cost of borrowing?



IMPACT ON USERS

- ▶ How will the proposed privatization proposal impact people who use the building? For example, what are anticipated impacts of the proposed privatization proposal of a public school building on students, teachers, maintenance staff, and others? For example, does the contract limit the ability of educators to use classroom wall space to display teaching materials, student work, etc.?
- ▶ In the case where the governmental entity pays the private entity for the public building through user-based rent payments, such as university dormitories, how will be users be impacted by the P3 arrangement? For example, does the university or the private entity have control in setting rent amounts and any subsequent increases? How much control will the private entity have in decisions about evictions of students who are unable to pay their rent?
- ▶ How will the proposed privatization proposal impact the broader community? For example, how will the P3 project and any other related development impact traffic?



LEGAL, REGULATORY, AND EXISTING CONTRACTUAL CONSIDERATIONS

- ▶ Are there existing state laws that apply to privatization or P3s that must be taken in account in any potential procurement?
- ▶ Are there local, state, or federal regulations or programs related to the public building or the services provided within the public building that could apply to or impact a potential privatization arrangement?



DEMOCRATIC CONTROL AND INCENTIVES

- ▶ Does the contract contain clauses that could run counter to future public planning and policy decisions? For example, will the contract limit or impact the ability to use the facility for other public functions, such as limiting a school from allowing local student sports leagues to use the facilities after hours? While not a P3 for a public building, the case of the Chicago parking meters P3 is illustrates the harm of these types of clause. The 2008 contract contains compensation clauses requiring the city to pay the private entity for lost revenue resulting from standard policy and planning decisions, such as the creation of new bike lanes or bus rapid transit lanes or temporary uses such as street fairs, for the life of the 75-year contract.

- ▶ Does the contract confer development rights onto the private entity? If so, what are the terms, conditions, and specifications for developing the public land or public indoor space? Are there specific conditions for what types of development can take place? For example, governmental entities may want to specify that a certain proportion of public land development is devoted to affordable housing. For any jobs that result from private development efforts, are there conditions around who in the community gets those jobs and requirement for minimum wages and benefits?
- ▶ How long is the contract? Many of these contracts can last for decades.
- ▶ Does the contract include termination and “buy back” clauses, which lay out how the governmental entity can take back control of the public building? Does the contract specify how the amount the governmental entity would pay to buy back control of the public building will be calculated?



CONTRACTING STANDARDS, OVERSIGHT AND MONITORING, AND AGENCY CAPACITY

Agency Capacity

- ▶ Does the governmental entity have the necessary experienced staff to negotiate a good deal for the public?
- ▶ Does the governmental entity have the necessary and experienced staff to ensure that outside analyses performed by consultants, etc., are fair and sound?

Consultants

- ▶ Will the governmental entity hire consultants to assist with parts of the deal?
- ▶ How are contracts with consultants, lawyers, and other third parties structured? Do they collect fees for services rendered or for successful completion of deals, regardless of the outcome for the governmental entity?
- ▶ Do the consultants, lawyers, or other third parties have any conflicts of interest? What is their track record and background with these types of contracts?
- ▶ Have the private contractors, investors, or consultants made campaign contributions to relevant decision makers?

Contract Standards

- ▶ Does the contract contain specific operations and maintenance standards, including a hand-back provision that specifies the minimum condition for the public building when it is returned to the public at the end of the contract term?
- ▶ Does the contract include performance standards that ensure timely and quality maintenance and/or operations?
- ▶ Does the contract include provisions related to default and bankruptcy of a private contractor to protect the state and the public in case the project or a private entity financially fails?

Oversight and Accountability

- ▶ Does the contract contain robust oversight provisions, including establishing regular reporting requirements and rights of the governmental entity to inspect and audit the public building?
- ▶ Does the governmental entity have a sufficient number of well-trained staff to oversee and monitor the privatization contract for the life of the contract?
- ▶ What rights does the governmental entity have to review and restrict refinancing, or sale of interest, by the private entity?



PUBLIC PARTICIPATION

- ▶ Does the contract contain appropriate and accessible mechanisms for members of the community, those who work in the building, and others who utilize the building to provide feedback and comments for the life of the contract?
- ▶ If the governmental entity allows the private entity to develop public lands or parts of the public building as part of the agreement, does the community have ample opportunity for engagement to better express community needs? Is the governmental entity actively seeking community involvement in the development process?
- ▶ Are there adequate and meaningful forums for public input during the initial proposal stage and any subsequent procurement, such as public hearings or public comment periods?
- ▶ Do the public, legislature, and other decision-making bodies have access to the information they need to evaluate the privatization proposal?



PUBLIC HEALTH AND ENVIRONMENTAL SUSTAINABILITY

- ▶ Does the contract include requirements for building an environmentally sustainable and resilient building?
- ▶ Does the contract include requirements and performance standards related to public health and safety of the building throughout the life of the contract?



WORKFORCE BENEFITS AND STANDARDS

- ▶ What will be the potential impacts on the existing and/or future workforce, including both the construction workforce and the long-term operations and maintenance workforce?
- ▶ Are the workers currently unionized and does the Collective Bargaining Agreement or government policy contain clauses that require workforce retention, retraining, or labor peace?
- ▶ If there is new construction, how many jobs will be created and what will the wages and benefits be for these jobs? In an existing building, how will the number of jobs and compensation change once control is shifted to the private sector?
- ▶ Who will receive any new jobs? Are there opportunities for a proposed project to include policies, programs, or agreements that ensure that residents in surrounding areas, especially those in nearby low-income urban or other disadvantaged communities, are offered employment and career training opportunities?
- ▶ If the private entity is engaging in development activities of public lands or inside public buildings, who will receive any new jobs associated with that development? Are there opportunities for a proposed project to include policies, programs, or agreements that ensure that residents in surrounding areas, especially those in nearby low-income urban or other disadvantaged communities, are offered employment and career training opportunities? Is there a community benefits agreement governing the new development?

