**Study Committee on Public Private Partnerships in Transportation**

**Final Report**

**December 2008**

Background

An independent study, using S.C. Department of Transportation estimates, concludes the State of South Carolina “faces a total shortfall of nearly $22 billion in the next 10 years… to relieve congestion, improve road conditions, implement needed safety enhancements and make needed bridge repairs and improvements.”[[1]](#footnote-2) This figure, more than three times the State’s annual budget, is exacerbated by ever-increasing construction costs and continued population growth. Further, the shortfall comes at a time of credit problems, the likelihood of recession, and state budget cuts.

Pursuant to Act 406 of 2008, the Study Committee on Public Private Partnerships in Transportation was tasked with studying “the feasibility and benefits of the construction, operation, and maintenance of roads, streets, highways, bridges, and tunnels through the utilization of public private partnerships and ventures” and to report its findings and recommendations to the General Assembly. Members include Senator Larry Grooms, Chairman of the Senate Committee on Transportation; Representative Annette Young, member of the House Ways & Means Committee; The Honorable Wallace B. Scarborough, former Member of the House; Representative Nathan Ballentine, a bank vice president and member of the Medical, Military, Public and Municipal Affairs Committee; Mr. Max Metcalf, member of the S.C. Infrastructure Bank Board; Mr. G. Clifton Parker, President and CEO of G & P Trucking; The Honorable Burnet R. Maybank III, an attorney and former Director of the State Department of Commerce; and Mr. Richard L. Tapp, Jr., Esq., member of the S.C. Transportation Infrastructure Bank Board.

To learn about the issues related to public private partnerships in transportation, the Study Committee held numerous meetings, including two public hearings. Informative, timely testimony was received from federal and state government officials, private sector financiers, engineers, construction executives, and national and local stakeholders. Based upon that testimony the Study Committee makes the findings and recommendations contained on pages 10-12 of this report. With the submission of this report, the Study Committee is dissolved.

Introduction

The United States Department of Transportation (USDOT) defines a public private partnership (P3) as “a contractual agreement formed between public and private sector partners that allows more private sector participation than is traditional.” The agreements upon which P3s operate “usually involve a government agency contracting with a private company to renovate, construct, operate, maintain, and/or manage” a transportation facility or system. Projects may involve the construction of new infrastructure, known as “greenfield” projects, or improvements in existing infrastructure, known as “brownfield” projects.

As the USDOT notes, “Private sector involvement in public transportation dates back to the beginning of road construction in the United States. Many of the earliest major roadways in the U.S. were private toll roads.” Private sector involvement declined in the mid-19th century as the federal government and states began building roads. By the 1940s and 50s, predominately in the Northeast, there were numerous toll roads built, but these were administered by public turnpike authorities. For many of the past fifty years or so, the motor fuel user fee, highway user fees, and other taxes have been used to finance transportation projects, while private sector participation has been limited to “entering into design and construction contracts with the state to build roads” on a fee for service basis.

The modern P3 concept can be traced to Europe, where Spain and France “pioneered the use of highway public-private partnerships” during the 1960s and 1970s. Today the practice is widespread throughout the world, particularly in Europe and Asia, and is becoming more popular in North America.

While the USDOT and the Federal Highway Administration (FHWA) actively promote partnerships, skeptics contend that P3s can be effective under proper circumstances but are not suitable for all projects. Tradeoffs ranging from potentially higher tolls under private operation,the fact that one generation may benefit at the expense of future generations, and a loss of some control over the location of new roads due to non-compete agreements in concession contracts must be considered. There are additional concerns about the general uncertainty and possible negative consequences of long-term contracts,and “academics and departments of transportation are starting to see that you can give away too much” in concession agreements.[[2]](#footnote-3) Proponents of P3s “in California, Texas, and other states have struggled to muster support for their own lease deals.” [[3]](#footnote-4)

Seven general methods of project delivery are recognized.

Design – Bid – Build. This is the traditional project delivery method. Design and construction are sequential steps in the developmental process.

Private Contract Fee Services. A public agency transfers responsibility for services it would typically perform in-house to the private sector, usually by awarding competitively procured contracts to the bidder providing the best value in terms of price and technical qualifications. Examples include operations and maintenance fee service contracts and program and financial management fee service contracts.

Design – Build combines two, usually separate services into a single contract. The public entity executes a single, fixed-fee contract for both architectural/engineering services and construction. The design-build entity may be a single firm, a consortium, joint venture or other organization assembled for a particular project. The Ravenel Bridge in Charleston was a design-build project.

Build – Operate – Transfer. Also known as turn-key procurement or design-build-operate-maintain (DBOM), this model combines the design and construction responsibilities of design-build with operations and maintenance. Design, construction, and operation of a single facility or group of assets are transferred to a private sector partner. This approach is used by a number of governments around the world.

Long Term Lease Agreements involve the long-term lease of existing (brownfield), publicly-financed toll facilities to a private sector concessionaire for a prescribed concession period during which the private entity has the right to collect tolls.  In exchange, the private partner must operate and maintain the facility and in some cases make improvements to it.  The private partner must also pay an upfront concession fee.

Leases are procured competitively and are awarded to the qualified bidder making the most attractive offer.  Generally, the most important consideration is the amount of the concession fee.  Other considerations are concession length and the bidder’s credit worthiness and professional qualifications.

Design – Build – Finance – Operate models bundle responsibility for designing, building, financing and operating projects, and transfers them to private sector partners. There is a great deal of variety in DBFO arrangements in the U.S., especially regarding the degree to which financial responsibilities are actually transferred to the private sector. One commonality in all is that they are either partly or wholly financed by debt leveraging revenue streams dedicated to the project. Direct user fees (tolls) are the most common revenue source. However, other sources, including lease payments, shadow tolls, vehicle registration fees, and availability payments may be used. Expected revenues are leveraged to issue bonds or other debt that provides funds for capital and project development costs. DBFOs often are supplemented by public grants in the form of money or in-kind contributions, such as rights-of-way. Private partners may be required to make an upfront investment of equity as well.

Build – Own – Operate models grant a private company the right to develop, finance, design, build, own, operate, and maintain a transportation project. The company owns the project outright, retaining in perpetuity revenue risk and profit. While this approach is more common in power and telecommunications sectors, it has also been used to develop transportation infrastructure.

According to the USDOT, long-term, concession based partnerships, such as the Long Term Lease Agreement and the DBFO, are “an increasingly utilized subset” of P3s. These partnerships shift to the private sector “a significant portion of the financial risk of the project, risks associated with the operation and maintenance of the project, and, in the case of new capacity and capital improvement, risks associated with the project’s design and construction.” While concession agreements are generally thought to involve tolls, some states have employed toll-free revenue structures.

Committee Hearings

Beginning in September, the Committee heard from representatives of the Federal Highway Administration, the S.C. Department of Transportation, the American Trucking Association and the S.C. Trucking Association. Executives with J.P. Morgan, Goldman Sachs, CH2MHill, Flatiron Construction, and Hochtief also appeared before the Committee. Experts in transportation and transportation partnering, those who testified are among the top professionals in the field of transportation, trucking, finance, engineering, construction, operation, and program management. Their work includes design and construction of the Ravenel Bridge, consultation for the Pennsylvania Turnpike privatization proposal, planning and construction of facilities for the 2012 Olympics in London, and program management for the multi-billion dollar expansion of the Panama Canal. Each representative either approached the Committee initially, or, as the case of CH2MHill, the company was asked to make a presentation because of its physical presence in South Carolina.

In advocating P3s, Federal Highway Administration asserted that relying on traditional funding – the fuel tax – is “ineffective, unpopular and unsustainable.” Presenters reiterated FHWA’s contention that partnerships may offer compelling advantages by allowing a state to tap private sector technical, management and financial resources in new ways.

FHWA maintained further that when combined with pricing, PPPs help align national policies. Pricing is a charge (toll) “that varies by traffic volume or time of day to balance supply and demand.” The method can be compared to pricing for airline tickets, movie tickets, long distance rates, and electricity rates. With a general public consensus existing to reduce gasoline consumption, P3s and pricing “help align energy, environmental and transportation policies by substituting private capital and direct user fees for gas taxes.”

Countering these beliefs, the American Trucking Association expressed its opposition to tolling, because it “distorts routing decisions” and complicates accounting and billing. The S.C. Trucking Association said private toll operators “are not held publicly accountable for the social impacts of tolls on low income workers or the costs to businesses, and privatization creates a ‘Balkanized’ federal highway system” and “does not protect national commercial interests.” The Association also asserted that a lack of national oversight allows states to move forward with vastly different plans. The ATA testified that “tolling carries very high administration costs, particularly when compared to the standard fuel tax.” The Association calls for profit caps; limits on concession agreements; limitations on the use of tolls to the tolled facility; restriction of unsolicited proposals; no tolls on existing roads; and independent traffic studies. Further, the Association suggests that legislation: require a project-specific public versus private financing analysis; prohibit non-compete clauses; be limited to I-73; require legislative approval for each agreement; and allow commercial users subject to the IFTA tax/IRP be reimbursed for those tax payments while operating on tolled facilities.

Financial sector representatives and construction and management executives who addressed the committee were much more positively inclined toward P3s. Each outlined several current trends. First, as J.P. Morgan executives noted, because there was significant transportation construction in the 1950s and 1960s, particularly on interstates, today’s infrastructure needs upgrading. Second, capital expenditures in transportation have trailed the nation’s population growth, a fact particularly true in poorer, high-growth states such as South Carolina. Third, construction costs have increased dramatically, fueled by competition from emerging markets in China, India, the Middle East and Eastern Europe. Fourth, the current credit crisis and recessionary concerns, combined with state budget cuts make it extremely difficult for states to finance large projects. Finally, these concerns are exacerbated by the recent $8 billion shortfall in the U.S. Highway Trust Fund.

Several consequences have emerged as a result:

* The level of debt once assumed by the private sector will no longer be available.
* Public equity pressure and increasing debt costs will reduce asset prices.
* More banks, rather than just a few, will be necessary to ensure adequate funding for individual projects.
* Other sources of funding may also be needed.
* Concession agreements will no longer allow a state as much contractual control as was found in early P3 arrangements.
* Availability payments are at the forefront of public private partnerships.

Availability payments, as Goldman Sachs explained, are based on the premise that the “concessionaire will build and/or operate an asset in exchange for a rent-like payment stream from the public sector.” Payments to the concessionaire depend upon its performance, and there are clear penalties and risks. Rather than revenue generating assets, where the concessionaire pays an up-front amount in return for future revenues, availability payments are used to subsidize assets. These payments may be used in conjunction with tolls or other public revenue streams.

While states may have difficulty accessing capital, Goldman advised the Study Committee that “there is an increasing growth and rotation of equity into the infrastructure sector,” with “a significant shift in the infrastructure funding market” over the past twelve months. For example, CalPERS, The California Public Employees’ Retirement System, manages pension and health benefits for more than 1.6 million California public employees, retirees, and their families. CalPERS and CalSTRS, the teachers’ retirement system, have recently allocated several billion dollars to infrastructure. So, too, have teachers in Texas. The Committee was advised that Canadians invest some ten percent of their pension funds in transportation-related ventures.

Further, Governors Ed Rendell of Pennsylvania, Arnold Schwarzenegger of California, and Mayor Michael Bloomberg of New York have called for more innovative financing by the federal government in conjunction with private investment. President-elect Barack Obama has called for establishing a National Infrastructure Reinvestment Bank that could bring new construction jobs and nearly half a trillion dollars in infrastructure spending.

While overall market trends remain uncertain, this very uncertainty suggests there is additional capital waiting to be invested. Goldman noted the recent “shift in sentiment toward leveraging public and private capital,” and noted that investing in infrastructure represents an economic stimulus. Additionally, J.P. Morgan indicated that because of increased P3 activity and the possibility of new federal aid, there is a “current, narrow window of construction cost declines right now.” The company also noted the increased interest and use of P3s generally, in Mississippi, Colorado and Texas.

Those testifying suggested several ways the State can best move forward with partnerships. CH2MHill, a global leader in program management, engineering, construction and operations, maintained that the current interest in transportation partnerships is strong “for well thought-out transactions.” The company believes the following factors are helpful to policymakers when deciding whether to use a PPP model:

* Are there opportunities for innovation in design and delivery?
* Are service objectives clearly defined?
* Are there financial savings?
* Are there an adequate number of bidders?
* Is there a potential for non-government streams of revenue?

Also, the State should develop a business case for the transaction, using a process in which project need is justified and objectives, risks, marketing and procurement tools are assessed. Procurement must be a fair and transparent process, with risk allocation explicit in the contract, and selection of a partner that best meets the State’s objectives.

Thorough preparation is a must, with comprehensive but flexible legislation in place prior to a presenting an RFP. CH2MHill cautions that the State should not go to market with a partnership proposal too soon. The proposal must be properly communicated to the public as a good idea, and “industry needs confidence that the project is real.” Further, as important as financing are the regulatory, institutional and operational fit of the project.

South Carolina’s Current Statutory Framework

Current law allows SCDOT to enter into partnership agreements with political subdivisions and private entities to finance by tolls or other financing methods, the cost of acquiring, constructing, equipping, maintaining, and operating highways, roads, streets, and bridges. The Southern Connector in Greenville and the Cross Island Parkway in Hilton Head were financed and constructed and have been maintained and operated pursuant to this provision. SCDOT also may award construction contracts on a design-build basis. A design-build contract may also contain provisions concerning the maintenance, operation, or financing of the project. The Code also contains several statutes related to toll roads, turnpike projects, and a new law allowing P3s for the operation of ferries.

However, SCDOT asserts that existing statutes are insufficient to support future, more comprehensive P3s. The department believes the following should be included in new legislation: (a) DOT authority to enter into concession agreements with private partners, (b) DOT authority to procure independently of the State procurement code, (c) limits on the length of concession terms, (d) limits on a private partner’s permitted rates of return, (e) clarification that eminent domain may be used, (f) DOT authority, at its discretion, to refinance and extend the term of a concession, and (g) authority to use tolls to cover all expenses of a project, including the private partner’s profit or rate of return.

The department addressed these issues with the Committee and has presented them in written form. SCDOT’s concerns are consistent with recommendations made to the FHWA in a report by Nossaman, Gunther, Knox & Elliott, LLP. The report was commissioned by the FHWA.

Federal Commitment to P3s

The federal government has increasingly favored the use of P3s. For at least the past 20 years, Congress has enacted pro-P3 programs, while the FHWA actively advocates partnerships and holds workshops across the country to assist local and state governments.

However, it is not clear that this trend will continue. The Chairmen of the U.S. House Committee on Transportation and Infrastructure and the Subcommittee on Highways and Transit recently cautioned states against rushing into public-private partnerships involving national highways. Congressmen James Oberstar and Peter DeFazio have told state leaders that the Committee could take action against PPPs “that do not fully protect the public interest and the integrity of the national system…”[[4]](#footnote-5) Also, it is uncertain that the Obama administration will continue the aggressively pro-P3 policy of the Bush Administration.

Currently the federal government offers:

**Financial Assistance**:

Private Activity Bonds. Permits the issuance of tax-exempt private activity bonds to finance privately developed and operated highway and freight transfer facilities.

TIFIA Program. The U.S. Secretary of Transportation may offer secured loans, loan guarantees, and lines of credit to assist in financing major transportation projects. The Ravenel Bridge was a TIFIA program.

**Interstate Tolling Programs:**

Interstate System Construction Toll Pilot Program. Authorizes tolling on three interstate facilities for construction of new interstate highways, provided that tolling is the most efficient and economical way to finance construction.

Interstate System Reconstruction and Rehabilitation Pilot Program. Authorizes tolling on three existing interstate facilities for reconstruction or rehabilitation of interstate corridors that could not otherwise be adequately maintained or improved.

Value Pricing Pilot Program. Authorizes tolls and provides grants for value pricing pilot projects to manage congestion.

High Occupancy Toll (HOT) Lanes Program. Authorizes variably priced tolls for demonstration projects on interstate facilities to manage congestion, reduce emissions in a non-attainment or maintenance air quality area, or finance additional lanes to reduce congestion.

Section 129 Toll Agreements. Authorizes tolling for five types of highway construction, including reconstruction of interstate bridges and tunnels, pursuant to 23 U.S.C. 129.

Findings

The Study Committee on Public Private Partnerships in Transportation finds that:

1. The traditional methods of financing, procuring, developing, operating, and maintain the State’s transportation infrastructure no longer meet the needs South Carolina’s citizens and others who travel state roadways.
2. By partnering with private entities pursuant to public-private partnership agreements, the State may more timely, efficiently, and cost-effectively address certain transportation infrastructure funding shortfalls.
3. The P3 model is not a fix-all for every project. However, under certain conditions, partnerships allow the State to maximize existing revenue that can help address some of our infrastructure needs in a timely, efficient manner. Interstate 73 is the prime example of a project ripe for a P3 venture that may not otherwise be undertaken.
4. Properly structured P3s benefit the State by delivering (a) expedited project completion, (b) cost savings, (c) improved quality and performance through the use of innovative materials and management, (d) substitution of private resources and personnel for limited public resources and personnel, (e) access to new sources of private capital, (f) the leveraging of private financial resources, concession fees, and the transfer of project risks to the private sector, and (g) allocation of risk of cost and schedule overruns to the private sector.
5. The S.C. State Infrastructure Bank should be considered as a valuable resource in partnership negotiations. The agency has a history of implementing innovative financing mechanisms.
6. South Carolina’s current statutory framework related to P3s is insufficient to support future, more comprehensive projects like I-73. The General Assembly should work with the Department of Transportation to identify key elements of successful P3 legislation from around the country and enact a comprehensive bill that will make South Carolina a viable competitor for private transportation investment.
7. P3 concession agreements are extremely complicated, lengthy documents. The DOT must engage legal, engineering, financial, and other specialists to ensure that any agreement entered into is thoroughly understood by all parties and is in the best interests of the State.

Recommendations

The Study Committee recommends that the General Assembly:

1. Declare that it is the policy of this State that, where appropriate, public private partnerships should be utilized for financing, procuring, developing, operating, and maintain our State’s transportation facilities to meet the transportation needs of the traveling public.
2. Enact comprehensive legislation that provides a fertile environment for P3 ventures. The legislation should include the following key components, many of which are identified by the FHWA:

* Transparency, oversight and public information sharing in soliciting and selecting partners. Project information, to the greatest extent possible, should be easily accessible. The public should be kept informed through hearings and website postings.
* The factors SCDOT may use in evaluating proposals should be explicit. These may include, but are not limited to: benefits to the public; the project’s proposed design, operation and feasibility; comments from affected jurisdictions and citizens; the general reputation, qualifications and experience of the partner; costs and financial plans; and the project’s ability to improve safety, reduce congestion, and promote economic growth.
* The department may limit the number of bids it considers, and unsolicited proposals should not be considered.
* Related to P3s, the department may procure independent of the State Procurement Code.
* The department and the partner should issue yearly reports updating the financial status of the project, and industry accepted accounting and auditing standards should be used in all instances.
* The Joint Bond Review Committee (JBRC) should pre-approve requests for proposals (RFPs) and contracts. Any non-compete clauses should be explicitly and separately approved.
* Relating to contracts, the JBRC should authorize and administer any availability payments; there should be no limit to a partner’s rate of return; the term of the agreement should not be in excess of the anticipated lifecycle of the project; agreements proposed in excess of 30 years require separate and explicit JBRC approval; and refinancing and extension of concession agreements are permissible.
* The use of funds from tolls should be limited to the facility on which the toll is collected, and tolling of existing roads should not be undertaken.
* The method of enforcement of violations of toll provisions should be addressed.
* Code clarifications should be made relating to eminent domain and other constitutional considerations.

1. Work with the SCDOT and the State Infrastructure Bank to facilitate P3 ventures when they are found to be in the best interest of the citizens of the State.

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1. *Future Mobility in South Carolina:* Meeting the State’s Need for Safe and Efficient Mobility; Prepared by TRIP for the South Carolina Alliance to Fix Our Roads; May 2008. [↑](#footnote-ref-2)
2. Belson, Ken. “Toll Road Offers New Jersey a Fiscal Test Drive”, New York Times (April 13, 2008) [↑](#footnote-ref-3)
3. Id. [↑](#footnote-ref-4)
4. James L. Oberstar and Peter A. DeFazio, Letter to governors and other state leaders, May 10, 2007. [↑](#footnote-ref-5)