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New Opportunities in a Down Economy: Position Your Firm Accordingly by Timothy Hegarty, Real Estate Weekly, December 21, 2011

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You know the three L's of real estate: location, location, location. The infrastructure in the New York Metropolitan Region, e.g., bridges, roads, transit, is teetering on the brink of disaster. It is increasingly more difficult to maintain our existing infrastructure, let alone find monies to fund new construction projects, and raising taxes is taboo in the current political environment. Due to the impact of this perfect storm, some governments are turning to the three P's of construction: public-private partnership.

The term "Public-Private Partnership" ("PPP" or "P3") has been around for many years, but has only recently begun to gain significant traction in mainstream media. In the construction world, P3 is defined as an arrangement between a public entity and private business in which the assets and skills of the participants are utilized to develop a public project. The best P3 agreements provide for an allocation of risk (e.g., project cost overruns, delays and risk of going bust) and reward (e.g., early completion and cost savings); safeguards against corruption; clear performance requirements, including management of both the construction process and the completed project; and termination provisions. Typically, the P3 project is funded by the private participant, which is then entitled to some, or all, of the income stream from the project.

The advantages of P3s are numerous. First, P3s reduce the public capital investment usually required to fund these projects. A fixed cost is negotiated at inception, but the private side does not begin to receive anything in return until the project is finished. Second, the development risk of such projects, which is completely the province of the government under the traditional method, is shared by both the public and private entities. Indeed, there is no litigation over deficient government-issued design documents. Third, and most important, a successfully completed project may benefit the public-at-large by potentially reducing taxes, improving the quality of life, raising property values and, to the extent it is a Greenfield type project, improving the environment.

Critics generally argue that the P3 structure is akin to "selling off" or otherwise ceding control of government assets to private firms. However, unlike true privatization, the government retains ownership and control of the project. The private company is essentially an investor, paid back from the project's revenue stream. Critics also argue that the taxpayers will be left holding the proverbial bag in the event the private side defaults. This risk can be partially mitigated by indemnity, surety and termination provisions. Critics further argue that public financing is less expensive than private financing and these projects are going to cost taxpayers in the end anyway. In exchange for the risk of providing their own money, private-equity funds, pension funds, high net worth individuals or other private investors, demand a proven, predictable cash-flow. While public financing is traditionally less than private financing, financing is only one element of the costs of the project.

Indeed, the better questions are whether these projects are truly needed and whether they will cost less than the traditional method. In terms of the latter, at ENR/NewYork's recent "Where's the Money? Funding Transportation Projects in New York State" conference, Christophe Petit of Star America Infrastructure Partners reported that a recent study in Canada revealed P3 construction projects deliver approximately thirty percent (30%) cost savings over the traditional delivery method. This makes sense because the private side not only wants to complete the project on-time and under-budget, but is often on the hook for 50 years or more of operation and maintenance and therefore has a powerful incentive to build a project designed to last in the long run. To the extent these savings can be relied upon, look for the P3 bandwagon to gain steam resulting in more state and local governments embracing the P3 delivery model in the Tri-State Region. Just remember the three P's of construction: public-private partnership and your firm will not be left behind.