



PUBLIC-PRIVATE PARTNERSHIPS:

A GUIDE TO SELECTING A
PRIVATE PARTNER

CDIAC



INTRODUCTION

In a public-private partnership (P3) arrangement, government and private entities share responsibility for project or service delivery. With a P3 arrangement, the public agency remains actively involved in overseeing a project, and the private entity may be responsible for project design, construction, finance and/or operations of the project. Given the complex nature of these financing arrangements, there is no cookie-cutter approach or formula for negotiating the partnership terms.

More detail on P3s, what they are, how they are structured, and how they differ from privatization is provided in the California Debt and Investment Advisory Commission's (CDIAC) Issue Brief, *Privatization vs. Public-Private Partnerships: A Comparative Analysis*. Another in a series on P3s from CDIAC, this analysis focuses on a key element for any public agency that is considering a P3 for project delivery: selection of the right private partner. This guide provides suggestions for the type of information that could prove useful to a public agency during the partner selection process and is divided into the following four sections:

- Who is the potential partner?
- The selection process
- Partner selection criteria
- Review of potential partner submissions



Also, it is important to remember that each P3 is unique; therefore, the public agency may need to construct additional questions to ask their potential private partner that address their specific situation. Ultimately, a P3 should result in a fair contract that balances the needs of both partners while ultimately protecting the public's interest.

WHO IS A POTENTIAL PARTNER?

Typically, a P3 involves a government agency contracting with a private partner to design, construct, operate, maintain, and/or manage a facility or system, in whole or in part, that provides a public service. The National Council for Public-Private Partnerships has identified what it considers to be the six critical components of any successful P3: political leadership, public sector involvement, comprehensive plan, dedicated income stream, stakeholder communication, and proper partner selection.¹ Of these six components, proper partner selection is one of the most critical elements for the long-term success of the partnership.

In particular, proper partner selection has greater significance for public agencies as the duration of partnerships has increased dramatically in recent years. Water and wastewater partnerships have progressed from 3 to 5 year partnerships to more long-term arrangements ranging from 10 to 20 years and larger infrastructure partnerships, such as toll roads, have partnership terms ranging

from 30 to 99 years.² As lengthier agreements become more common and acceptable, establishing a long-term working relationship with a private sector partner becomes a critical factor for the success of the partnership.

There are many types of private sector entities, including engineering, construction and financial institutions that could be potential partners. By utilizing a private partner, a public agency can benefit from the expertise, knowledge, resources and experience that the private partner has with project design, finance, management, operations, or other specific project components not usually available to a public agency. The challenge is finding the appropriate partner or partners.

Examples of Private Partners:

- CH2M Hill OMI of Denver, Colorado and Veolia Water, headquartered in France specialize in water, wastewater, and utilities maintenance, management, and operation services for public agencies.
- Cintra of Spain and Transurban based in Australia are private developers of transportation infrastructure and toll roads, respectively.
- Macquarie Infrastructure Group of Australia, Depfa Bank of Dublin, Ireland, and Goldman Sachs of New York are financial institutions that provide investment resources for infrastructure projects.

For larger types of infrastructure projects, such as toll roads, a consortium of partners, each with different fields of expertise, can partner with a public agency. For example, in 2006, the Macquarie Infrastructure Group (investor) and Cintra (developer) led a consortium known as Statewide Mobility Partners that paid the State of Indiana \$3.8 billion to lease and collect tolls on the 157-mile Indiana Toll Road for 75 years.³

THE SELECTION PROCESS

The P3 procurement process can present the best opportunity for a public agency to build a partnership with a private partner. For a P3 in general, the scope of work, schedule and plan of finance often cannot be precisely determined; therefore limiting the use of the traditional public agency “low bid” procurement process. Instead, most P3 projects use the public Request for Qualifications (RFQ)/ Request for Proposals (RFP) process with the public agency selecting a partner based on the “best value” to the agency for the duration of the partnership, rather than to the lowest bidder.

To begin the selection process, a public agency has to be able to give potential bidders information on the agency’s need or proposed project, project parameters, including public agency contribution to the project, timeline, and current condition of the existing facility or proposed facility location. Giving potential bidders as much information as possible will ultimately benefit the public agency, as they will receive more detailed proposals for consideration.

A public agency generally will use a multi-step process to select a private partner. Typically the first step consists of a RFQ to determine an eligible pool of candidates. The resulting “short list” of candidates are invited to submit a full RFP, consisting of the partner’s technical proposal. Given that each P3 is unique, the selection process should be customized to meet the public agency’s needs. For some projects this may involve an additional preliminary step where prior to requesting an RFQ, a public agency solicits Expressions of Interest to determine if there is any interest from outside firms to participate in a P3 with the public agency. Alternately, some public agencies may use only the RFP process

that determines the partner, project proposal and P3 structure all in one solicitation. A successful procurement will attract competitive proposals from qualified parties, obtain attractive terms that meet the public agency’s procurement objectives and result in an equitable contract that fairly serves both partners as well as the public.

The following represents the key information a public agency should request from a potential private partner in order to perform an in-depth review of each potential partner:⁴

- Description of the Proposed Partner
- Qualifications & Experience
- Financial Capability
- References
- Risk Transference
- Litigation & Controversy

This information will assist the public agency in finding a partner that is experienced and will bring the “best value” to the P3 over the term of the long-term partnership.

Highlights:

- The public agency is seeking a private partner that will bring the best value to the project as opposed to the lowest bidder.
- Factors that can contribute “value” to a project include, but are not limited to: project design, project delivery schedule, use of innovation, access to expertise, project financing and user fee schedule (if applicable) over the duration of the partnership.

PARTNER SELECTION CRITERIA

DESCRIPTION OF THE PROPOSED PARTNER

A public agency should seek a partner that can meet the objectives of the project, and has demonstrated expertise sufficient to complete the project.

- **Review description of the proposed partner.** Ultimately the public agency is looking for information that will help determine if the partner can fulfill the agency's objectives. A full description of the partner should include identification of the proposed team as well as the proposed management style for the project.⁵ The information submitted should provide an overview of the partner including history of the organization, ownership, corporate structure, and any additional information that conveys the potential partner's plan to fulfill the agency's objectives as stated in the agency's solicitation documents.

An important side note for a public agency is that P3s are a global prospect, with the United States (U.S.) emerging as new territory for P3 development. P3s have been more widely accepted and are in more advanced stages of implementation in Australia, Canada, and Europe than they have been in America. Therefore, a foreign-owned or -operated firm could respond to a U.S. government's partnership solicitation. This fact should not necessarily deter a public agency from considering a foreign-owned partner, as many foreign P3 partners have had success and have established positive reputations in their respective business field. In addition, recent trends in transportation P3 development reflect global toll-concession companies partnering with U.S. firms.⁶

Example: Fluor, a U.S. based contractor, and Transurban, an Australian toll road developer and investor, have partnered with Virginia Department of Transportation on the Capital Beltway High Occupancy Toll Lanes projects.⁷

As U.S. companies gain experience from these joint ventures, it is likely that fully U.S.-owned toll road companies will emerge in the next five to ten years.⁸



Once a public agency has selected a private partner, the resulting partnership agreement will assign the roles and responsibilities of each partner.⁹ Specifically, the contract spells out monitoring and compliance mechanisms and defines the private partner's responsibility to grant access and to make regular reports. Typically, there is an arbitration mechanism for disagreements about whether the provisions of the concession agreement are being met, a process for remedying deficiencies, provisions handling default by either party, and finally hand-back requirements that come into play if the concession is terminated prematurely or at the end of the concession term.¹⁰

Example: According to a Macquarie Infrastructure Group Fact sheet, toll roads are usually managed by special purpose companies with a legally enforceable concession agreement signed by both the public and private partners. This agreement sets out the concessionaire's obligations and rights for operations, the toll setting mechanism and collection of tolls for a defined period.¹¹

Legally enforceable agreements not only benefit the local agency but also the private partner. Macquarie Infrastructure Group sees this as an important feature, and as a result invests in countries with well developed legal systems.¹²

Highlights:

- Based on the information provided by the potential partner/ consortium, the public agency should have a comfort level with who the partner is, including history of the organization, ownership, and corporate structure.
- Public agencies should have all agreements reviewed by legal counsel to ensure their rights and remedies are well represented. Legally enforceable agreements provide the basis for the P3 and protect all parties.

QUALIFICATIONS & EXPERIENCE

The response to the public agency's solicitation should reflect the qualifications and experience that a potential private partner would bring to the P3 and how it would benefit or enhance the public agency's project. Depending on the structure of the proposed P3, the public agency should be considering the relevancy and extent of specific technical experience and expertise of the designated key staff members of the submission team, not simply the entity as a whole. The public agency should also analyze how this experience and expertise benefits the public agency and the project. Benefits of the partnership can include accelerated project delivery, greater access to technology and innovation, risk transference, alternative financing methods and cost-efficiencies that can result in lower project delivery and/or operating costs. Ultimately, the partnership should provide some measurable public benefit that the public agency can not access or achieve without the private partner.

- **Obtain proposed private partner qualifications and experience.** The public agency should look for the relevancy and extent of prior project experience as well as professional and technical qualifications of the proposed partner and individual team members. Specifically, the submission should include the resumes and references of each of the proposed team members. This information should reflect professional experience or technical expertise that is relevant to the development and/or completion of the proposed project and should reflect experience working with public agencies. Past performance information is valuable because it can be used as an indicator of a potential partner's ability to meet the public agency's objectives.

Desirable qualifications may include certificates of technical knowledge, education, and professional experience, including years in the specific business sector, experience with a project of similar size, nature, and complexity, as well as experience with public agencies.

- **Review a list of the proposed partner's projects completed and under construction.** A list of projects completed and/or under construction should reflect the relevancy and extent of prior project experience by the proposed partner

including size, nature, and complexity of prior relevant projects. This list should be representative not only of relevant projects but of past work completed or undertaken for similar public agencies both in size and industry. This information will assist in determining if the potential partner has the necessary experience to complete the tasks.¹³

- **Interviews.** Part of the solicitation process should include an interview. This interview gives the public agency and potential private partner a valuable opportunity to meet potential partners one-on-one. This is a final opportunity for a prospective private partner to demonstrate to the public agency that it is the right selection for the partnership.

The Water Partnership Council suggests that all parties involved in the partner selection process should be present at the interview, including the mayor, city council, engineering staff, legal department, any technical advisors and other pertinent public agency representatives.¹⁴

Highlights:

- Verify experience to ensure the private partner possesses the qualifications and expertise necessary to meet the public agency's objectives.
- Schedule interviews to meet potential partners one-on-one with all parties involved in the selection process present.

FINANCIAL CAPABILITY

One potential advantage of a P3 is the additional financial resources that a private partner can bring to the project. As a result, the public agency should perform some level of due diligence to confirm that proposed resources exist and are available for its project. In addition, the public agency should review the financial viability of the partner. A financial review of any potential partner can help protect the agency and public funds from being committed to a partner that may not be financially suited to fulfill the agency's long-term objectives.

- **Review the most recent financial data, including audited financial statements.** A review of the potential partner's audited financial statements and other budget or annual reporting documents can help to provide insight to the financial health of the proposed partner. Annual reports can document a company's fiscal policies, including budgeting strategies and debt levels that have contributed to the firm's financial stability. Past fiscal performance can also serve as an indicator of future performance. The public agency should require updates to this annual information for the duration of the agreement. As a guide, a public agency should review at least three to five years of financial data.

- **Confirm available net working capital and net worth of submission team.** The public agency needs to confirm the available net working capital proposed for the P3 as well as the bonding capability of the proposed partners. The public agency should follow up on bank and surety references. In addition, the agency should ensure that the team members are not the subject of any litigation so there are no potential outstanding financial entanglements.¹⁵ Lastly, it is not unreasonable for a public agency to request that a financial review be undertaken and certified by an independent financial consultant prior to final selection.

- **Review proposed alternative funding approaches.** In addition to experience and expertise, a public agency is looking for a partner that can provide access to capital that would leverage existing agency resources. Most P3s leverage public funds through tolls, user fees or other project related revenue

including naming rights (typically associated with sports facilities) and privately-financed interchanges (in which developers pay for interchange improvements or installation in exchange for the increased development potential resulting from the improved accessibility provided by the project).¹⁶ While state and local governments already have access to multiple financing tools including redevelopment tax increment financing, private activity bonds, Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) loans, and state revolving loan funds, additional capital may be needed to fulfill state and local governments' current and future infrastructure needs.

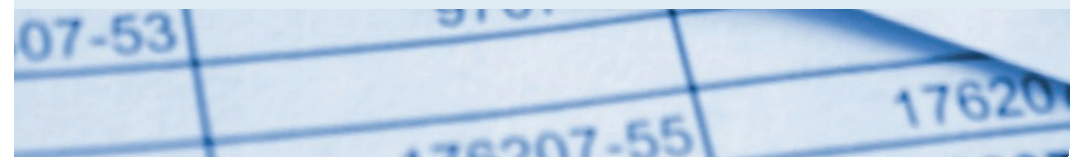
Initially, any project must be financially feasible for both partners. The private sector will expect to earn a "reasonable" rate of return on their investments in P3 projects; the rate of return should equate to the amount of risk the private partner is assuming. Usually the private sector brings to the partnership the ability to deliver a project in a timely and cost-effective manner, thereby maximizing any direct revenue sources.¹⁷ In addition a private sector partner may propose the use of equity, debt, bank loans, and/or capital markets to finance the project.

In evaluating the funding sources proposed by the potential private partner, the public agency should look at each proposal and its overall value for the duration of the P3. This includes the involvement of the public agency in proposed treatment of any "windfall" profits resulting from the project, any revenue-sharing proposals with the public agency, and setting, controlling and collection of user fee schedules (especially for toll roads).



Highlights:

- The agency should review and verify the potential partner's financial capability.
- Past fiscal performance can serve as an indicator of future performance.
- If the agency lacks the expertise to perform a financial analysis, an independent financial review can be performed and certified by an independent financial consultant chosen by the agency prior to final partner selection.
- A review of the proposed alternative funding sources should demonstrate the overall value to the public agency for the duration of the P3.



REFERENCES

One of the most valuable pieces of information a public agency can get from a potential partner is a list of references.

- **Request and contact references.** As part of any RFQ process, a list of references composed of previous public agency partners should be requested and contacted. When following up on the references, the public agency should make sure the person listed as the reference contact actually worked directly with the partner in question and determine in what capacity. The public agency may request to speak to other staff that worked with the partner in other capacities for the same project. References can provide information regarding their interaction with the private partner and staff, insight on issues they encountered, the resolution process and the responsiveness of the private partner to any agency concerns. The list of references should include projects and public agencies which are similar to the requesting public agency and proposed project. Contacting references is the agency's chance to find out first hand how a private partner will actually perform once selected.

Highlights:

- Request a list of references that includes other public agencies and projects similar to that being proposed.
- Contact the references provided, speaking to staff that worked directly with the partner.

RISK TRANSFERENCE

There are varying levels of public and private sector risk with P3s. The advantage of a P3, however, is that risk can be transferred to the partner that is better equipped to manage or prevent that risk from occurring or that is in a better position to recover the costs associated with the risk. The goal of a P3 is to combine the best capabilities of the public and private sectors for mutual benefit.

- **Reduce public agency risk.** A public agency can better manage risk by transferring project related risk to an experienced private partner that is equipped to handle the risk. Project related risk elements that a public agency most often transfers to the private partner can be project costs and financing, construction schedule, and quality assurance.

Example: If a private partner assumes responsibility for financing and building a highway, it also assumes responsibility for the related risks such as interest rates fluctuations, construction scheduling, and changing labor costs.

Highlights:

- An advantage to a P3 is that the public agency can select a partner to share the risks as well as the rewards of the project.
- A public agency should select a partner that is better equipped or more experienced than it to handle certain risks associated with the project.

LITIGATION & CONTROVERSY

Another issue of due diligence to be performed by the public agency is to ensure the prospective partner is not involved in any litigation and free of controversy that might jeopardize the P3 project.

- **Ensure that the potential partner is free of litigation and material controversy.** The potential partner should provide a written statement that the proposed company and individual team members are not the subject of any litigation or material controversy.

Highlight:

- A public agency wants to avoid a partner that is currently the subject of litigation or mired in controversy, which can negatively impact the public perception of a partnership before it begins.

CONTINUED FOLLOW-UP

It is important to note that the public solicitation process takes time and the information submitted by the potential partners is current as of the time of submission. With this in mind, the public agency should ensure that it always has the most up to date information on its potential partners prior to finalizing its selection and receives updated information on a periodic basis for the term of the partnership.

- **Request any changes in the proposed consortium, financing plan or changes to the financial stability of the partnership.** By requesting updated information, the public agency will have documentation of any changes that occur during the process. This includes updated annual information as it becomes available, as well as information of any deletions or additions made to the partner or consortium since the original submission to the public agency.

Highlight:

- A public agency should continue to perform its due diligence by ensuring it has the most recent information on the potential partner/consortium during the selection process as well as once a final partner has been chosen. It should continue to receive relevant information (such as additions/deletions to the partnership) on a periodic basis throughout the term of the partnership.

REVIEW OF POTENTIAL PARTNER SUBMISSIONS

The public agency must instill confidence that it will conduct the review and selection process in an open and fair manner. Proposals must be evaluated solely on the criteria specified in the agency's solicitation. Evaluations may be conducted using any rating method or combination of methods, so long as they are specified in the solicitation. A public agency should keep a record of any strengths, deficiencies, weaknesses, and concerns supporting the evaluation of each proposal in the contract file as support for decisions made during the selection process.

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KEY QUESTIONS A PUBLIC AGENCY SHOULD ASK ITSELF WHEN REVIEWING A POTENTIAL PRIVATE PARTNER'S CREDENTIALS:

- Does the expertise meet the public agency's needs?
- What is the proposed approach to the project?
- Is there value for money in the proposal?
- Is this an organization and staff that the public agency will feel comfortable working with for the duration of the partnership?





CONCLUSION

A P3 can be an innovative approach for securing high value-for-money-invested. As a result, a public agency needs to be certain of the choices it is making when entering into a P3. As discussed in an earlier CDIAC publication, *Privatization vs. Public-Private Partnerships: A Comparative Analysis*, every aspect of the contractual relationship in a P3 is important, however as discussed in this guide one of the first and arguably the most important choices a public agency makes when entering a P3 is the selection of its private partner. The selection process, therefore, should identify and pre-qualify those prospective partners that have the greatest potential for developing and delivering the proposed project as a P3. A successful partnership should ensure that both the public agency and private partner will have an effective business relationship. Finding the right partner is integral to the success of the P3, therefore, an agency should not feel compelled to select a partner that does not meet all of its specified needs.

PRIVATE PARTNER EVALUATION CRITERIA CHECKLIST

Expertise

Financial capacity

Acceptance of risk transfer

Demonstrated experience in delivery of similar projects

Demonstrated experience in working with similar public agencies

Capacity to deliver the required quantity and quality of project/services

Proposed infrastructure & end of term treatment

Proposed timelines for the project

Additional resources and capacity

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References and End Notes

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- 3 Macquarie Infrastructure Group, Asset Portfolio, Indiana Toll Road, www.macquarie.com.au/au/mig/asset_portfolio/us/indiana.htm. (Last visited January 4, 2008).
- 4 Private partner for this discussion refers to any private company, investment firm, etc. that could forge a partnership with a public agency.
- 5 A proposed partner takes different forms: it can be a single entity or a consortium of multiple private firms.
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