



**A Primer for
Government
and Institutional
Decision Makers
who are Considering
Public-Private
Partnerships (P3s)**



So You're Considering a P3

BY DANIEL MARSH III

With the global insurer AIG predicting that the United States will soon become the world's largest market for public-private partnerships (P3s), many state and local governments are taking a serious look at the potential of P3s to realize social and traditional infrastructure needs. But the complexity of P3 structures can be daunting. Without expert guidance, governments may find themselves on an unproductive P3 path after a lot of time and effort has already been expended.

Worse yet, decision-makers need to guard against opportunists selling too-good-to-be-true "solutions" for complex and challenging projects.

Fundamentally, P3s are a financing mechanism, not a source of funding. That is an important distinction — otherwise known as the “no-such-thing-as-a-free lunch” rule.

Deciding when and how to use P3 financing requires a lot of due diligence. That includes knowing how to spot red flags. The most glaring red flag is when for-profit investors insist on total control of the asset while shifting all the risk to a public entity through minimum revenue guarantees. This is not a “partnership”; it is privatization of public assets with taxpayers on the hook. Another red flag to look out for is when a potential private partner has experience with only one type of project but is looking to create new opportunities in another sector. They may not know enough about that sector to accurately analyze the costs and benefits.

Of course, avoiding an unproductive P3 path goes beyond spotting red flags; it also involves understanding the spectrum of financial structures. There is some confusion about what exactly constitutes a P3. Traditional public procurement sits on one end of the spectrum, while privatization is at the other end. Neither one is a P3. In between these two poles are true P3s that blend the public-private relationship in different ways—including NDC's nonprofit P3 model — with each one solving for different variables.

And that is the heart of the issue. While there are some very good P3 guides out there, picking the right P3 structure starts by asking this important question: Of all the variables of a particular project, which one is most in need of private-sector expertise? Is it a complicated construction project, and therefore the risk needs to be mitigated? In that case, an experienced private contractor takes on the risk and is incentivized for doing so. That is a productive P3 relationship.

Then there is the case of a public entity in financial distress. Borrowing can be costly to the point of crippling a project. A credit-worthy partner with the ability to leverage tax-exempt financing can save enough money to move the project forward. Or perhaps the project is relatively straightforward but time is of the essence. In such a case, project delivery needs to be streamlined, which can only be done through a public-private structure.

One of the most common P3 challenges to emerge in recent years is when the “capital stack” for a complex project incorporates many financing sources and includes for-profit operations and maintenance. Take, for example, the project to restore and reopen the historic Kings Theatre in Brooklyn.

The New York City Economic Development Corporation, arguably one of the country's most sophisticated finance and development municipal nonprofits, worked tirelessly to assemble a P3. But the inclusion of a for-profit theater owner in the complex financing structure created a budget-busting tax liability. Outside expertise was needed, and the National Development Council was brought in to restructure the capital stack and ownership structure. The magnificent theater, which had closed in 1977, reopened in 2015, and is now considered to be an economic development success, revitalizing nearby retail and spawning new businesses, including a new hotel.

Outside expertise can make the difference between a successful P3 structure that benefits the community and a troubled project that becomes a political liability. Here we provide information about how P3 structures solve for different variables, as well as how NDC's own nonprofit model works. Perhaps more importantly, rather than learning the hard way, decisions makers who are considering P3 projects can build up their institutional knowledge by seeking technical assistance and transferring that knowledge in-house—bolstered by ongoing education and training.

Daniel Marsh III is the President and CEO of NDC, where he has worked since 1986 to bring capital and financial expertise to under-served communities.

Photo by Matt Lambros



There is some confusion about what exactly constitutes a P3. Traditional public procurement sits on one end of the spectrum, while privatization is at the other end. Neither one is a P3. In between these two poles are true P3s that blend the public-private relationship in different ways with each one solving for different variables.

Public Procurement

Public Financing

Public Procurement is the traditional method for building public works projects. It is best used when the government entity is in a strong position to issue tax-exempt financing (muni or GO bonds); has long-standing relationships with builders; and can operate the project using public resources, and/or contract easily for maintenance. Traditional highway construction is the most well-known example of the design-bid-build process. Increasingly, however, public procurement is moving toward a design-build model for more complex projects that have multiple subcontractors (such as large public parks). But these projects are still publicly funded, publicly owned and publicly maintained, and therefore are not a true P3.

Public Ownership, Private Operations

Public financing

When private operations and maintenance become part of the package, this is when a true P3 structure becomes necessary. This approach works best when public financing and public ownership need to be maintained, but the program and maintenance of the development is complicated and requires expertise. Publicly owned airports and stadiums often use this structure.

P3 Structures

Joint Venture

*Mix of public and
NON-PROFIT Financing* | *Mix of Public and
FOR-PROFIT Finance*

Joint ventures have some combination of public and private financing and ownership. The difference between a non-profit and for-profit model, however, is that with a non-profit P3, the project can take advantage of tax-exempt financing. This is best used for social infrastructure developments between \$5M-\$50M that do not generate a revenue stream (see NDC case studies).

P3s that include for-profit investment and/or ownership are typically used for large, complicated projects that have a revenue stream associated with operations. Multi-billion-dollar airport reconstruction projects in both Los Angeles and New York City are utilizing this structure.

Privatization

Private Financing

Privatization usually means a government sells off the asset in its entirety and the public no longer pays for or controls the asset. But recently some projects labeled P3s were really privatization schemes. The government ceded long-term control to a for-profit investor while requiring minimum revenue guarantees from tolls or parking fees. This is not a true P3 arrangement.

“THE AMERICAN MODEL” Non-Profit P3 Structure

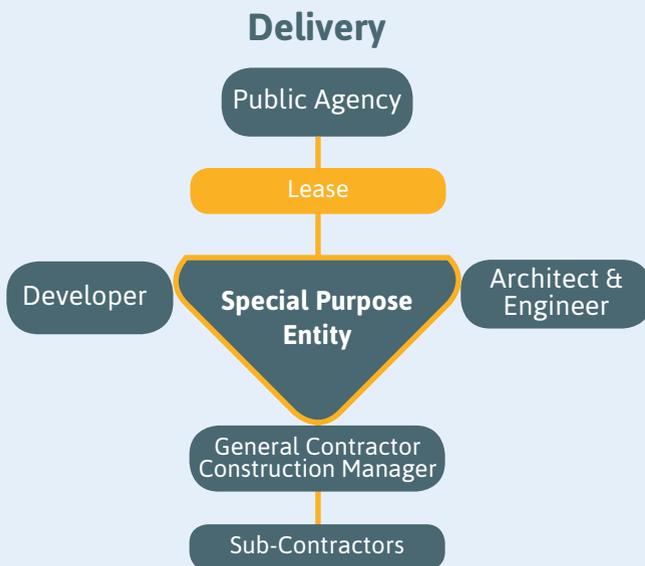
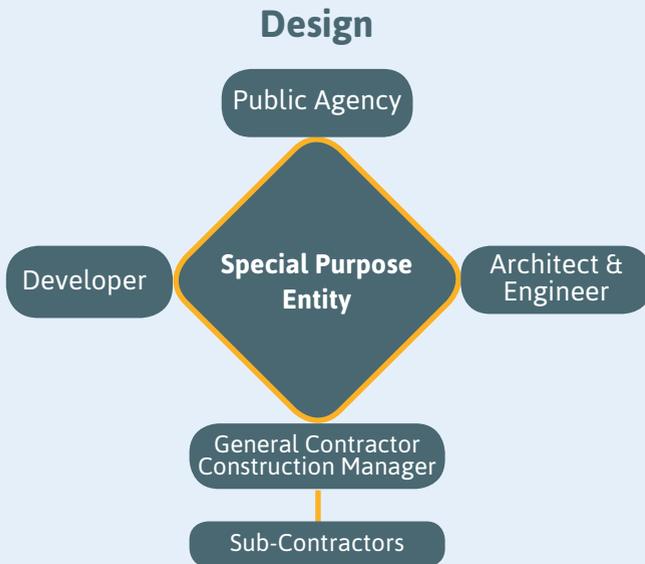
When most people hear “P3,” they assume the project involves a for-profit investor. But that doesn’t have to be the case. Since the late 1980s, the National Development Council has pioneered a nonprofit P3 model that is largely geared toward funding social infrastructure in small and mid-sized cities. NDC projects include municipal offices, city halls, justice centers, laboratories, student housing, libraries, biomedical facilities and hospitals.

Using this nonprofit P3 model, NDC can realize any project that involves either a government agency or a non-profit institution (such as a university or public authority). NDC has completed more than 3.7 million square feet of usable development space valued at over \$2.5 billion.

The non-profit P3 model is a very different approach compared to the for-profit model that can result in the privatization of public assets, or greatly increased costs because the for-profit investor demands high returns—or both!

NDC’s nonprofit status allows for tax-exempt financing. This is no small matter. In the last decade, tax-exempt municipal bonds financed two-thirds of the more than \$2 trillion that was spent on infrastructure across America. If market rates of return were applied to that financing, by some estimates the cost to local taxpayers would have increased by \$495 billion. And yet, there could be even more savings that accrue to communities by utilizing nonprofit, private sector management expertise.

Public procurement is not typically managed by a nonprofit that has assumed responsibility for bringing projects to fruition on time and on budget. One recent study of public works budgeting showed cost overruns averaging 50 percent more than the original estimate. By contrast, NDC has met all budgetary and timeline commitments for more than 40 P3 projects—sometimes completed early and under budget.



HOW IT WORKS

The American Model blends tax-exempt debt with private development expertise. To achieve this, NDC sets up a not-for-profit owner/issuer of tax-exempt bonds, hires a private developer, architect and general contractor and charges them with developing the facility. This development team is under contract to assume construction and delivery risk. They are given the tools to do so, including incentives to build efficiently and to strict quality standards.

After construction is complete, the facility is leased to the governmental/institutional client and then transferred to the client at no cost when the debt is retired. Rent, dictated by the lease, is set at the debt service plus operating costs. There is no operating profit nor disposition profit since the development team is not required to bring equity to the structure or take on operating risk. The development team earns a development fee commensurate with the development risk they take on and nothing more.

THE BENEFITS

- The special purpose nonprofit entity can incorporate tax-exempt financing into the capital stack, such as New Markets Tax Credits, Historic Tax Credits, and other grants without incurring tax liabilities
- The nonprofit entity has the flexibility to manage the development process more efficiently than the public sector
- The nonprofit board includes representation from the governmental/ institutional client (keeping the “public” in the P3 relationship)
- In the case of a revenue-generating project, such as parking garages, the nonprofit entity returns any proceeds back to the community through grant programs

Case Studies

from downtown redevelopment to student housing



Downtown Ithaca, NY

*\$55M three-phase downtown redevelopment
85,000SF of office, hotel, parking, retail and apartments
Completed in 2003, 2005, 2012*

NDC was engaged by the City of Ithaca in 1998 to provide technical assistance for an economic development plan that would revitalize downtown. This plan included creating space for Cornell to locate offices downtown, as well as a lure a hotel, retailers, entertainment and residents with new apartments. NDC expanded its technical assistance relationship with Ithaca by forming P3 partnerships at three phases of the redevelopment efforts. The P3s involved tax-exempt bonds as well as New Markets Tax Credits and other financing mechanisms. Twenty years later, Ithaca consistently ranks as one of the most livable places in America.



Yonkers Public Library, Yonkers NY

*\$53.3M bond issue
209,000SF library, office and auditorium
Completed 2013*

The City of Yonkers partnered with NDC to renovate an abandoned industrial building, formerly occupied by Otis Elevator, to house both the Yonkers Board of Education and the Yonkers Public Library, as well as a public auditorium. The historic 1923 building occupies a prominent location on the city's waterfront across from the Yonkers' central train station and Larkin Plaza, a refurbished urban park that has become a national model for reclaiming abandoned urban waterways for public use. The completion of this building ushered in a new era of economic development in downtown Yonkers.



Redmond City Hall, Redmond, WA

\$39.2M bond issue

107,000SF office, 453-space parking garage

Completed 2006

By 2002, the City of Redmond found that more than 160 of the 300 city employees were housed in office spaces across Redmond at a cost to the city of more than \$500,000 per year. The City decided to build a new city hall to consolidate its offices. NDC worked with the City of Redmond to lease land and hire a developer to design and construct a state-of-the-art city hall that would better serve the city's growing population. When the bonds were retired in 2013, ownership of Redmond City Hall fully reverted to the city at no additional cost.



Rainier Place, Lynnwood, WA

\$16.2M bond issue

181-bed student housing for

Edmonds Community College

Completed 2009

Having no on-campus housing or prior experience in developing student housing, Edmonds Community College reached out to NDC to help finance and project-manage its first on-campus student housing project. Since opening, Rainier Place's 55 studio, two and four bedroom units have been at 100% capacity, with revenue from rentals dedicated to paying off the bonds. At the end of the 30-year bond period, Rainier Place will be turned over to the college at no additional cost.

Case Studies

from new construction to historic restoration



Center for Urban Waters, Tacoma, WA

\$38M bond issue

51,000SF office, laboratory

Completed 2010

NDC worked with the City of Tacoma, the University of Washington and the Puget Sound Partnership (a not-for-profit dedicated to cleaning up Puget Sound) to build the Center for Urban Waters. Located on the Thea Foss Waterway, the shared research facility is a state-of-the-art, LEED Platinum marine research and testing laboratory constructed on a former brownfield site, providing a beacon of possibility in an industrial neighborhood. The building was a finalist for an Urban Land Institute Award for Excellence.



Riverside County Law Building, Indio, CA

\$44.38M bond issue

90,363SF office space

Completed 2015

Through a rigorous RFP process, Riverside County selected NDC and developer Trammell Crow to finance and build a new office building for the county's District Attorney, Public Defender, and County Counsel. The building includes multiple sustainable features, such as extensive sun shading devices, drought tolerant landscaping, electric vehicle charging stations, photovoltaic parking shade structures, recycled content, low-emitting building materials and many other solutions that earned the building LEED Platinum Certification. The County Law Building was completed four months early and about \$2 million under budget.



Kings Theatre, Brooklyn, NY

\$95M financial package

89,000SF historic restoration, 10,000SF expansion

Completed 2015

Brooklyn's Kings Theatre opened in 1929 as one of Loew's "Wonder" theaters. Working with the New York City Economic Development Corporation, NDC played a critical role in the redevelopment of the dilapidated yet historically important community asset. NDC stepped in as the non-profit lease-holder of the building while providing technical assistance to structure a complicated financial package totaling \$95M worth of public, private and tax-exempt financing (including New Markets and Historic Preservation tax credits). Closed since 1977, the reopening of Kings Theatre has revitalized nearby businesses and spurred new development, including a hotel.



Our Mission

NDC's work focuses on HOMES, JOBS and COMMUNITY. Founded as a national nonprofit in 1969, NDC has worked for almost 50 years fulfilling its mission to increase the flow of capital for investment in low-income communities. NDC directs capital to support the development and preservation of affordable housing, the creation of jobs through training and small business lending and the advancement of livable communities through investment in social infrastructure.

Our Work

NDC acts as partner, teacher, advisor, investor, developer and lender, bringing together technical know-how and capital for community and economic investment. We work with local and state governments and community-based organizations to help them create and implement their own unique economic and community development strategies. Over the years, our programs and services have evolved to reflect the changing policy environment, adding services and products to meet emerging needs. We provide technical assistance, professional training, small-business lending, debt and equity financing for residential, commercial, public, and nonprofit facilities. Our nationally-recognized training programs help build a professional workforce in economic and community development that can advance and sustain progress in their communities.

Our History

In nearly five decades, we have helped improve the lives of millions of people through new economic opportunity and community improvement, in every one of the 50 states and Puerto Rico.

NDC Headquarters

One Battery Park Plaza,
24 Whitehall Street Suite 710
New York, NY 10004
(212) 682-1106

ndconline.org

