Transportation Public-Private Partnerships in Arkansas: The Road to P3s in the Natural State

04/04/2018

Over the last several years, the federal government has promoted public-private partnerships ("P3s") as one way to address the dire need for American infrastructure investment. States agree. For example, last year in Arkansas, the Public Facilities and Infrastructure Act – P3 enabling legislation – was enacted to increase infrastructure development in the Natural State. The engineering and construction industries also agree on this infrastructure investment need. In the American Society of Civil Engineers' 2017 Infrastructure Report Card, the ASCE stated that the United States needs to spend $2 trillion more than it currently spends on infrastructure between 2018 and 2025 in order to achieve a B- grade. There is a $2 trillion gap, and P3s are designed to help fill this gap.

As a construction lawyer and project finance attorney in Arkansas who has worked on a number of P3 projects in other states, I am elated that my state has embraced this project delivery and finance method. But what is a P3, exactly? How do P3 transportation projects operate? And, can P3 transportation projects work in Arkansas? I endeavor to answer these questions in this article.

What is a P3?

According to the Federal Highway Administration, public-private partnerships are "contractual agreements between a public agency and private entity that allow for greater private participation in the delivery of financing of projects... [including] design-build-finance-operate-maintain." A P3 is not a private replacement for public infrastructure investment, rather it is a supplement. Because state and local governments have limited financial resources to provide all of the necessary roads, bridges, ports, and airports, there is certainly a need for supplemental financing and funding.

To help state and local governments with financing and funding, private companies, which have more access to private financial markets and less debt restrictions, can provide some of these needed infrastructure assets and services to the public. This is not privatization by any means. A city, for example, maintains oversight and control of the infrastructure project's construction and operation – a wastewater treatment plant for example. And, the city typically owns the real property and will own the wastewater treatment plant improvement at the end of the agreement's term. The P3 in this scenario provided public infrastructure that the city may not have otherwise provided.

The P3 Agreement

When a public entity enters a P3 agreement with a private company, the agreement has four important features. *First*, the agreement must have a term or concession period. For example, if a city wants to use a

P3 for our new wastewater treatment plant, including designing, building, financing, operating & maintaining, then the private company will perform these obligations over a long period, such as 30 years (the term). For this term, the company will operate & maintain the plant, receiving, treating, and discharging wastewater. Though the company will exclusively provide the operation & maintenance services upon construction completion, the plant will transfer back to the city at the end of the term or concession.

Second, because all viable P3 projects require a stable and sufficient project revenue stream for the term, P3 agreements have payment mechanisms. If a private company or joint venture invests millions of dollars in providing an infrastructure asset for the public, the company reasonably expects a return on its investment. Thus, there must be a payment mechanism to repay the company and provide a return. Despite the myth, P3s are not "free money" projects. Further, there really is nothing mysterious about a P3. In terms of structure, a P3 looks a lot like a revenue bond deal, except there is a lender instead of bondholders and a project company instead of a city public facilities board (note, however, that revenue bonds may sometimes be a tranche in a P3 capital structure). In both cases, the project must generate a revenue stream to repay investors.

There are two primary payment mechanisms: revenue risk and availability payments. A *revenue risk* P3 means the private company typically collects revenue directly from the public in the form of user fees. For example, a private company that finances, builds, and operates a new parking deck for a city airport collects parking fees from drivers. The key point here is that the private company takes the risk of revenues that fall short of its cash flow projection. The *availability payment*, on the other hand, is a sum of money that a state agency or city pays to the company. Using our city airport parking deck example again, the private company finances, builds, and operates the deck, but the city will make monthly payments to the company. Here, the company collects and submits parking revenues to the city, and the city pays the company from the revenues – and the city takes the risk for parking revenue shortfalls.

Third, another key feature involves project delivery and value for money ("VFM"). In traditional public project procurement, the government entity, such as a city, issues municipal bonds or is appropriated money to finance or fund an infrastructure project. The city then contracts with a private architecture & engineering firm to provide design drawings and specifications. After the public bidding process, award, and project completion, the city operates the project.

With public-private partnerships, however, the process is quite different. The focus is on VFM. VFM, which occurs at the proposal evaluation phase, is an assessment of what type of project delivery provides the best value for public money for the life of the project (e.g. 60 years). VFM not only determines the suitability of a project to be a P3, the outcome of a VFM assessment determines the best project delivery method as well. Different project delivery methods may have different VFM values. Should the P3 company design, build, finance, operate & maintain ("DBFOM") the project? Or, is it a better value for the city to finance the project with municipal bonds that are tax exempt, contracting with the private company to provide a DBOM delivery? For example, would it cost a city *less money* for availability payments to a P3 company to finance, build, and operate a drinking water treatment plant for 30 years than it would cost a city for municipal bond principal & interest payments and operation & maintenance costs for the same period?

Fourth, the last P3 agreement feature is risk allocation. Without going into the minutia, P3 agreements allow the public entity and private company to creatively allocate risks during construction and operations. For example, for a commuter rail line, such as Denver's Eagle P3, does the city or the P3 company bear the risk for easement acquisition cost overruns and delays? Or, to use the city airport parking deck example again, who bears the risk for parking fee revenue shortfalls?

P3 Transportation Projects

Public-private partnership transportation projects are not new in the US as a general matter. Throughout the 1800s, federal and state governments granted land to railroad companies to finance, design, build, and operate railroads. The modern P3 model, however, is relatively new to America. Though widely used in European countries for motorways since the 1990s, American states have only started warming up to transportation P3s over the past decade. A few recent examples of large P3 transportation projects include Denver's $1.3 billion I-70 expansion and Texas' $2.9 billion Grand Parkway. Transportation projects are different than other projects, such as parking decks and water treatment plants, but the P3 fundamentals are the same.

For a new expressway project, a state department of transportation, after conducting the VFM assessment and thoroughly reviewing proposals, would select the best payment mechanism – revenue risk or availability payment. The P3 company providing a DBFOM will begin operating the project upon its completion of the construction phase. Upon reaching commercial operations, the revenue stream begins.

A good example of revenue risk payment (user fee) for the expressway project is a toll. Here, the private company will have toll booths at the entrances and exits of the expressway, and the tolls the company collects constitute the revenue stream. To streamline tolling, the expressway could also use electronic tolling (no toll booths for toll collection). On the other hand, if the DOT uses availability payments, the private company will not collect tolls or be paid per driver. The DOT will make monthly payments to the company for the road to be available, and these monthly payments constitute the revenue stream. Again, in this availability payment option, the expressway may not even have tolls, and the private company will not be affected as its revenue comes from the state DOT – regardless of the number of drivers on the expressway. Thus, a transportation P3 could be based on a user fee from drivers, a payment from the state DOT, or a combination of the two.

Arkansas Transportation P3 Options

The $2 trillion investment gap in nationwide infrastructure also affects the Natural State. In Arkansas alone, there is an annual funding gap of $450 million for transportation construction and maintenance. P3s can also help Arkansas. There are two statutory options for P3 transportation projects in Arkansas. The first is the new Partnership for Public Facilities and Infrastructure Act ("P3 Statute"), and the second is the transportation statute in the Arkansas Code ("Transportation P3 Statute"). Transportation projects procured or operated under these statutes do not have to undergo competitive bidding.

Arkansas' P3 Statute is located at A.C.A. 22-10-101 et seq., and it permits an Arkansas state agency to enter a P3 agreement with a private party to provide toll roads, highways, bridges, and the like. However, section 22-10-105 of the P3 Statute excludes "projects of the Arkansas Department of Transportation." In effect, Arkansas' P3 Statute excludes the vast majority of transportation projects that would be suitable for a P3. This enabling legislation applies to transportation projects, but only a few.

The better statutory alternative for a transportation public-private partnership is the Transportation P3 Statute, which is located at A.C.A. 27-67-206(j). This Arkansas Code Transportation Chapter provides that the Arkansas Department of Transportation via the commission can enter design-build, design-build-finance, design-build-operate-maintain, and concession P3 agreements with a private party. As it sounds, a design-build project means that the P3 company designs and builds the transportation project. In addition to design-build, the Arkansas Department of Transportation ("ArDOT") may also contract with the P3 company to finance or operate & maintain the project.

The Transportation P3 Statute also permits ArDOT concession agreements, and the statute defines *concession* as a "lease, franchise, easement, permit, or other binding agreement transferring rights for the use or control of a transportation facility by the commission to a private partner under this subsection." The AR concession P3 is arguably as close as it gets to a standard P3 in other states.

Arkansas' First P3 Transportation Project – Maybe

Arkansas' first transportation P3 may be an extension of I-49 from I-40 at Alma to Highway 22 at Barling (near Fort Smith), which includes a bridge over the Arkansas River. This *shorter* I-49 project, with an estimated total cost of $380 million, is part of a larger effort to extend I-49 from the Fort Smith area to Texarkana. For this longer I-49 project, the estimated cost to extend I-49 from the Fort Smith area to Texarkana is $2.5 billion or more.

ArDOT contracted with infrastructure consulting firm HNTB in late 2017 to study the shorter I-49 project. HNTB's *I-49 Alternative Delivery Study* is generally focused on recommendations for viable project delivery methods but will likely specifically focus on whether a revenue risk P3 makes sense, using tolls. At the moment, a P3 appears to be a good option, considering project schedule advantages and ArDOT's annual budget constraints. However, projected cash flows from tolls based on projected traffic will be critical to I-49's suitability as a P3.

In conclusion, regardless of the transportation project or the location – whether I-49 in Arkansas or I-70 in Colorado – public-private partnerships offer another avenue to deliver and finance projects. P3s are not the answer to the Arkansas infrastructure problem, but P3s can certainly help.

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