

# Framework Conditions for Foreign and Domestic Private Investment in California's Infrastructure: Seizing the P3 Opportunity

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prepared for the  
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## **Introduction**

The Bay Area Council Economic Institute has prepared this white paper for the California Business, Transportation and Housing Agency as a reference for considering what steps should be taken by the state to attract a growing flow of private domestic and international capital to transportation and other infrastructure projects in the state. The passage of SB 4 and the formation of California's Public Infrastructure Advisory Commission (PIAC) in 2009 created a window and process designed to enable private investment in transportation projects. The issue now before the state is how to generate and sustain a substantial deal flow that addresses California's underlying infrastructure needs. This analysis discusses specific public policy and regulatory factors that will either enable or impede that investment. These findings and recommendations reflect research by the Economic Institute. They are not a statement of State of California policy and do not necessarily reflect the views or positions of the administration or the Business, Transportation and Housing Agency.

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# **Framework Conditions for Foreign and Domestic Private Investment in California's Infrastructure: Seizing the P3 Opportunity**

## **Public-Private Partnerships and Infrastructure Investment in California**

California's 37.9 million population and \$1.8 trillion GDP place it first among U.S. states. Its GDP ranks eighth among nations globally, according to the World Bank, on par with the U.K., Brazil and Italy. According to the Organization of Economic Cooperation and Development (OECD), the typical levels of infrastructure investment in developed economies range from 1% to 2.5% of GDP. In California, past under-investment in maintaining and upgrading infrastructure, combined with economic and population growth, suggests an investment requirement of approximately 2.5% of GDP, at the upper end of the OECD range.

- ◆ At an investment level of 2%–2.5% of GDP, California would need to invest \$424–\$530 billion in its infrastructure over the next 10 years.
- ◆ If 20%–30% of this amount were through public-private partnerships (P3), the level of private capital needed would be in the range of \$85–\$159 billion.
- ◆ Assuming 70% leverage, this translates to \$25–\$48 billion in equity.

While not targets, these figures suggest the magnitude of California's infrastructure financing challenge, particularly when compared with the level of investment being made by other large economies. Core infrastructure can be financed and operated using models ranging from public finance and construction, to public finance with

private construction (Design-Build), to public-private partnerships where a private partner, under appropriate government terms and supervision, provides end-to-end project delivery (Design-Build-Finance-Operate-Maintain). As suggested above, there is substantial potential for private capital to contribute to the financing and delivery of infrastructure in the state.

Assembly Bill 680, passed in the early 1990s, first opened the door to public-private partnerships in transportation by authorizing four projects, two of which were built: the SR 125 toll road in the San Diego-Mexico border area, and the SR 91 toll project in Orange County. Government Code 5956 (the Infrastructure Finance Act) subsequently opened the door to public-private partnership (P3) projects sponsored by local governments. Most recently, the passage of Senate Bill 4 in February 2009 expanded the number and scope of projects open to private investment, among other things by removing the prior cap of four on development-lease agreements undertaken by the Department of Transportation and regional transportation agencies, by providing greater flexibility in the terms and conditions that could be included in an agreement, and by extending the authorization for those agreements to 2017. California now has a number of processes and transactions actively underway that embody P3 principles:

- ◆ **LA Measure R:** A number of California jurisdictions (“Self Help Counties”) are currently investigating the potential of P3, building on voter-approved sales tax increments to support local transportation projects. Perhaps most significant because of its scale is Measure R, approved by voters in Los Angeles County in 2008, which commits a projected \$40 billion to traffic relief and transportation (highway and transit) upgrades over the next 30 years. LA Metro is systematically evaluating P3 as a means to better leverage Measure R funds, with the goal of achieving a much larger project scope.<sup>1</sup>
- ◆ **California High-Speed Rail:** The current estimated cost to build the 800-mile system is \$45 billion. The California High-Speed Rail Authority anticipates

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<sup>1</sup> Measure R, Los Angeles County Metropolitan Transportation Authority

that the commitment of \$10 billion in voter-approved state investment plus additional Federal dollars will attract private sector funding totaling approximately one third of project cost, and has identified an array of public-private partnership pathways, including debt financing, vendor financing, system operations and private ownership.<sup>2</sup>

- ◆ **Administrative Office of the Courts, Long Beach Courthouse:** California's Administrative Office of the Courts (AOC) solicited proposals for the P3 Design-Build-Finance-Operate-Maintain (DBFOM) development of the new \$400 million Long Beach Courthouse, and announced its selection in June 2010. The AOC has over 800 California courthouses in its jurisdiction, the majority of which are in need of some form of upgrade or improvement. The total cost of the statewide upgrade program is expected to be in the range of \$10 billion, and the AOC plans to use the Long Beach Courthouse as a model for many of the projects that it will undertake in the coming years.<sup>3</sup>
- ◆ **University of California Campus Improvements:** Over the last decade, the University of California has used P3 methods to build and operate a variety of structures spread over more than 60 projects. The two most recent examples are the Neuroscience Building at UCSF, a project that combines public finance with private development and operation, and the West Village project at UC Davis, an extensive development utilizing the DBFOM model, that includes faculty and student housing, office and retail space, and community college facilities.
- ◆ **Public Infrastructure Advisory Commission:** Created by Senate Bill 4, passed in 2009, the Public Infrastructure Advisory Commission (PIAC) is an advisory commission that serves as a center of expertise to advise the state, together with the California Transportation Commission (CTC) and regional transportation agencies, on the selection of transportation projects for P3

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<sup>2</sup> California High-Speed Rail Authority

<sup>3</sup> California Administrative Office of the Courts, Long Beach Court House RFP

development. Unlike counterpart agencies in Canada and the U.K., the PIAC does not engage directly in procurement transactions, but instead (1) identifies transportation project opportunities, (2) advises the California Transportation Department (CalTrans) and regional agencies on project selection, and (3) serves as a repository of information on best practices. Initial projects being evaluated include the Presidio Parkway in San Francisco (approved by the CTC on May 20, 2010), the Bay Area Express Lane Network, the Desmond Bridge/I-710 freight corridor in Long Beach, and the Westside Subway Extension in Los Angeles (part of LA's Measure R). Projects under consideration by the PIAC, combined with other projects under Measure R, potentially constitute one of the largest transportation improvement programs in the United States.

- ◆ **Local projects Under Government Code Section 5956 (The Infrastructure Finance Act):** Section 5956 expresses the intent of the Legislature that local government agencies have the authority and flexibility to utilize private investment capital for infrastructure development purposes. Section 5956 cannot be used for state projects—including toll roads on state highways, state water projects, state park and recreation projects, or other state financed projects—and to date has been lightly used, principally for local water projects. Several projects under 5956 are currently advancing in California communities, including the Rialto Water Concession and the Marin County Emergency Management Center.

Details on Assembly Bill 680, SB 4, and Government code Section 5956 can be found in the Appendix.

Each of these processes and projects incorporates P3 approaches and, in the aggregate, they represent an ambitious infrastructure investment agenda. California has made significant advances in the last five years in developing a regulatory framework to enable P3 projects in the state, which if acted upon could turn California into one of the world's most promising global investment opportunities.



But while the initiatives outlined above define a world-class investment opportunity, the primary challenges confronting the state relate not only to general opportunity but more specifically to the types of projects that are being brought to market, their revenue underpinning, and the state's framework for governance. These challenges stem largely from California's political climate and its myriad of cross-cutting laws, regulations and public policies; resistance from public sector labor unions; and occasionally resistance by local residents. On the execution side, global best practices in P3 development have outpaced California's established procurement environment. A review of the largest and most impactful worldwide infrastructure projects (*The Infrastructure 100*, published KPMG and the Infrastructure Journal) shows that P3 is playing a central role in global asset formation—but not in California.

Given the state's challenging fiscal circumstances and the probability that they will not improve significantly in the near-to-medium term, this is an important time to focus on P3 strategies. The creation of the state's Public Infrastructure Advisory Commission is particularly well timed, as potential foreign partners look to California for what may for the first time be a critical mass of P3 projects. It is important, therefore, that California consider the conditions that will either incentivize or deter those partners from committing their resources to California's economy.

## **The PIAC and Transportation Context**

Senate Bill 4 (SB 4) created the Public Infrastructure Advisory Commission (PIAC) to facilitate project execution and market access. Consistent with global experience, not all California infrastructure projects will be a fit for P3 investment, and a determination must be made on the merits and the appropriateness of each proposed project for P3 development. In California, the PIAC will play an important role in determining in each case whether there is significant public benefit to engaging the private sector as developer and operator, or whether the project should more appropriately be built and operated by a public entity. From the viewpoint of government agencies, such expertise can be invaluable in deciding whether and how to venture into a new program and in identifying objective standards to apply in decision-making (e.g., risk

transfer and whole life cost savings). From the private investor's standpoint, the proposed project must offer the opportunity of a market return on investment, based on either cash flow generated by the project or an availability/lease payment by the state or local entity for the services being provided. The state's process for P3 governance can have a major influence on private-sector perceptions of a project's risk-return ratio and its ultimate viability for P3 development.

A June 2006 study by the Bay Area Council Economic Institute (formerly the Bay Area Economic Forum), *Investing in California's Infrastructure: How to Ensure Value for Money and Protect California's Competitive Position in the National and Global Economy*, analyzed the criteria—based on experience in the U.K., Canada and elsewhere—that are critical to determining which projects should be considered as P3 candidates. The PIAC can play an important role in developing the standards and criteria that will apply in California. It should be noted at this point that the PIAC and its role are not unique. Global best practices offer many successful examples of operational government entities in the U.K., Australia, Canada, and elsewhere in Europe and Asia that are actively playing the role contemplated for the PIAC.

Noteworthy examples include:

- ◆ Partnerships U.K., in the United Kingdom;
- ◆ Infrastructure Ontario, in the province of Ontario, Canada;
- ◆ Partnerships BC, in the province of British Columbia, Canada.

Each of these organizations embodies a model program incorporating a center of expertise that is capable of representing governmental entities in addressing all of the elements of P3-style contractual arrangements, covering a range of applications and structures. In each case, government authorities recognized early on that then-existing public procurement processes were outdated. The presence of a qualified center of expertise capable of providing a clearly defined, reliable and predictable procurement process that meets a high standard of fairness and transparency is often cited as the most important factor in attracting capital to a particular jurisdiction.

While significant progress has been made, it is not yet clear, however, that California meets this standard, or that it is equipped with the tools necessary to ensure that it can effectively compete in attracting private capital. Illinois, Florida, Texas and Virginia all have competing programs which benefit from the experience that comes from having begun earlier.

## **Global P3 Investment Sources and Market Participants**

In all, more than 45 countries have created administrative units to manage P3 programs. These agencies engage a range of domestic and international funding sources, setting up a competitive environment for P3 funding.

Global and domestic equity investment in P3 projects comes from several primary sources, each of which may have differing considerations when evaluating investment opportunities. These include pension and endowment funds; infrastructure funds (principally supported by pension funds as Limited Partners and other private equity funds); and sovereign wealth funds.

The typical capital structure of a P3 project is multi-tranched and consists of a layer of equity, above which sits one or more layers of public and/or private debt. Debt can take a number of forms including tax-exempt financing, Build America Bonds, private activity bonds, industrial revenue bonds, commercial bank debt, and other forms of private placements, together with federal support programs such as the Transportation Infrastructure Finance and Innovation Act (TIFIA) or energy loan guarantees.

The recession of 2008–2009 hit state and local government in the U.S. particularly hard—California being no exception. California may now face debt service levels approaching 10% of revenues. Some in the global investment community look to the Debt Service Ratio (DSR), the ratio of annual debt service costs to yearly revenues, as a general guideline or indicator as to whether a state has become overextended in its debt burden. In past years, concerns have been voiced when a state's DSR began to exceed 5 or 6 percent. Rating agencies generally consider prudent debt in

the 3–4% range to be acceptable and 6% to be high and approaching the maximum acceptable level. California is entering uncharted territory, suggesting that alternative methods of procurement such as P3 may need to be more aggressively considered. To utilize the P3 approach, however, California must have both a credible regulatory framework and financially viable projects.

## **Principal Sources of Equity Investment**

For infrastructure projects, the principal domestic and international sources of investment are:

### ***Pension & Endowment Funds***

Interest by sovereign and public pension funds in P3 is increasing, as infrastructure offers a relatively stable, long-term asset class with modest but attractive returns. The pension fund universe is principally defined by U.S., European, Canadian and Australian funds that typically act in one of three capacities:

- ◆ Direct investors (5% or less of global pension funds);
- ◆ Co-investors (up to 10% inclusive of direct Investors);
- ◆ Passive Limited Partners (90% of pension funds).

Limited Partners (LPs) invest by selecting a General Partner (GP) to act as an agent. GPs are infrastructure funds that aggregate capital under a management contract. The most active segment in the market is defined by GPs who act on the behalf of LPs.

All three classes of investors may invest directly in project debt or equity, or in listed or unlisted private infrastructure funds that assemble equity finance from multiple sources. They may also work through a “fund of funds” that invests in multiple listed or unlisted infrastructure funds, though this is not currently the preferred or dominant approach.

### ***Infrastructure Funds and Other Sources of Private Equity***

Infrastructure funds are pooled investment vehicles, typically structured in the general partner/limited partnership format, that aggregate resources from multiple pension funds or other sources for the purpose of investing in infrastructure assets. Infrastructure funds range in size from \$250 million to \$10 billion plus, with many in the \$1 billion range. A \$1 billion fund may have as few as 10 or as many as 30 institutional investors. Most are staffed to perform the full range of management functions (deal sourcing, transacting, asset management and exiting).

### ***Sovereign Wealth Funds***

Sovereign wealth funds, investment vehicles owned and funded by national governments, account for only a small minority of investors. They generally prefer a less visible role as investors, remaining in the background. A key issue from their perspective is the level of confidence that can be placed in the controlling entity in the financing consortium. A small number of sovereign wealth funds will invest directly in infrastructure, with the majority investing in funds managed by GPs. In those instances where sovereign funds invest directly, they typically join forces with other large global investors and avoid taking the lead, being apprehensive about the related visibility and political risk. It is rare for a sovereign fund to enter a deal process at an early stage. Most prefer to enter when the deal is either in syndication or at an advanced stage of development.

While access to sovereign capital may be an option for California, the likelihood of sovereign sources addressing the larger needs of the state is low. There are no examples globally of sovereign funds leading infrastructure programs geographically outside their own jurisdictions.

## Other Market Participants

### *U.S. Government Institutions*

The U.S. Government historically has played an important role in infrastructure asset formation. Federal involvement spans all areas of infrastructure including energy, transportation, water and waste, communications, and social infrastructure. In the transportation sector, the development of the interstate highway system, airports and maritime ports have been a central focus. Federal programs are complimented by state and local programs, where tax exempt municipal financing has formed the backbone of infrastructure finance. The U.S. has a long and successful history in combining with local tax-exempt municipal finance a myriad of federal, state and local programs incorporating various forms of grants and, on a more limited basis, loans. But this view of U.S. infrastructure is becoming dated. Today the U.S. faces a number of critical challenges in reforming its institutional approach to infrastructure asset formation and procurement. Current considerations include:

- ◆ Uncertainty about whether and how to extend Build America Bonds—under the 2009 American Recovery and Reinvestment Act, Build America Bonds can provide a federal subsidy for the taxable borrowing costs of state and local governments, supplementing traditional tax-exempt sources and allowing access to a broader pool of funding resources;
- ◆ Uncertainty regarding P3 policy at the federal level;
- ◆ A lively but inconclusive debate about the creation of a National Infrastructure Bank or National Infrastructure Fund and the future of direct federal lending programs like TIFIA (Transportation Infrastructure Finance and Innovation Act) and RRIF (Railroad Rehabilitation and Improvement Financing Program);
- ◆ Uncertainty over the advancement of the next transportation bill in Congress and systemic long-term uncertainty related to the viability of the gasoline tax and the National Highway Trust Fund; and

- ◆ At all levels, laborious pre-development regulatory processes can lead to delayed project completion.

Overall, the U.S. appears to be entering an extended debate on infrastructure finance that is still comparatively ill-defined in the context of global best practices.

### ***Export Finance and Multi-Party Funding***

Multi-party financing has become a constant of global infrastructure investment. Some of the most visible investment strategies around the world are founded on export credit programs or agencies that tie the availability of capital to the purchase of goods and services in the sponsor country.

National export finance funding may be combined with an array of other finance sources involving multiple parties. In California, the relevance of multi-party funding can be illustrated by the California High-Speed Rail (HSR) project. HSR needs capital, a portion of which is likely to come from equipment suppliers and contractors. By global standards, it is a major project requiring the skills and resources of the global engineering, procurement and construction community. To some degree, the participation and competitiveness of global contractors, engineering firms, and equipment suppliers is likely to be defined in part by the participation of their own sovereign institutions. The most likely form of this participation is by an export credit agency providing low-cost financing and/or loan guarantees backing their home country companies' participation in a project. In the case of HSR, we are already seeing the Chinese, French, German, and Spanish export credit agencies' presence as components of their respective country teams. California should therefore consider a procurement process for high-speed rail that incorporates and encourages the participation of export credit agencies (ECAs) from around the world, when appropriate.

## **Commercial Banks**

Project financing has a long history in the infrastructure world, and the commercial banking community has played a central role, though in recent years private equity firms have moved to the forefront of the action. There are two roles played by bank-based project finance, broadly defined around advisory and capital-raising services.

*Advisory:* Advisory services can cover the full range of transaction types, from brownfield mergers and acquisitions to greenfield project financings and the full range of capital sources.

*Capital-Raising:* The availability of commercial bank credit for infrastructure investment has proven to be complicated, as U.S.-based banks more or less exited the business at the end of the 1990s and now participate on the short end of the maturity spectrum (at maturities of three to five years or, in some cases, as long as seven years). Although longer maturities are starting to make a come-back, the U.S. market currently relies more on “mini-perm” structures. In contrast, European banks have been far more active, embracing longer-term commitments (as seen in recent commitments to major U.S. infrastructure projects in Florida and Texas).

This is in part explained by the breadth and depth of the tax-exempt bond market in the U.S. While brownfield M&A-style deals have predominated in the infrastructure space during the last 10 years, due to the perceived simplicity and lower risk of acquiring existing assets, recent financial challenges brought on by the recession promise to rebalance the asset class. Most vulnerable have been projects that depend on anticipated user fees as opposed to government availability payments (e.g., the Indiana Toll Road and the Chicago Skyway). Banks have played a key role in financing recent greenfield projects such as the Miami Tunnel, Florida’s I-595, Virginia’s I-495, and the LBJ Expressway in Texas—all of which commenced before the financial meltdown. For the future, banks are likely to give increased attention to the comparative risk and return of brownfield versus greenfield investing, considering that the politics of greenfield investing may ultimately be easier, even if the regulatory processes and financing packages required to close the deal may be more difficult.



Another issue for banks is the long period of most P3 concessions. It is possible that shorter durations, with refinancing (and the entry of pension funds) after the initial high-risk construction period, would serve to bring more commercial bank financing into the market.

Given the financial challenges facing local government in the aftermath of the recession and related limitations on municipal financing, private financing is likely to play a larger role in infrastructure asset formation going forward. This, in turn, opens the door to a bigger role for domestic commercial banks, as the potential scale of needs in the U.S. is too large to depend solely on European banks.

This will require one or both of: (1) U.S. commercial banks reentering the business of making loans to projects; and/or (2) the implementation of the National Infrastructure Bank (or Fund) strategy that has been under consideration in Congress. A globally competitive stance would suggest that both are necessary. In the EU, the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB)—along with numerous ECAs, commercial banks, investment banks, and public and private debt and equity investors—reflect a much more refined set of multi-party asset formation and funding options than is available in the U.S. today. The State of California already does business with many U.S. and foreign commercial banks, so it should be well-positioned to engage these players as partners in its infrastructure development activity.

In sum, California's State Treasurer's Office, Infrastructure Bank, Department of Finance, Transportation Commission, PIAC, and Department of Transportation (CalTrans) plus its regional transportation agency partners should consider a unified approach to synthesizing a globally competitive version of multi-party financing in the state.

## Factors Impacting P3 Investment

While there are many factors that play into investor preferences around infrastructure, the central focus for the majority of investors concerns accessing long-lived assets that produce stable cash flow. The key factors that define any asset include:

- ◆ Industry and geography;
- ◆ Political, legal and regulatory conditions and processes;
- ◆ Demand inelasticity that defines a stable revenue stream either by the nature of the activity or contractual arrangements;
- ◆ Contractual structure and risk sharing;
- ◆ Qualifications and experience of government sponsors, project management, and corporate joint venture and financial partners;
- ◆ Governance structure and definition of roles and responsibilities; and
- ◆ Economic returns.

### ***Foreign Investor Considerations***

Foreign direct investment (FDI) is a major contributor to California's economy, supporting jobs and competitiveness, and generating tax revenue. For any jurisdiction, whether a city, county, state or nation, success in attracting foreign investment is a vote of confidence in its future. FDI decisions typically are based on investors' perceptions of "big picture" factors such as the availability of a quality workforce, efficient infrastructure, the cost of doing business, technological capacity, government capacity, and local market potential.

Flows of FDI are subject to global competition, as they offer access to financial resources and technical expertise that may not be otherwise available internally. From a competitive standpoint, therefore, FDI will tend to flow to jurisdictions that

offer the framework conditions with the highest potential to generate a significant risk-adjusted return on investment.

While investment in P3 projects can come from either domestic or overseas sources, the factors that will make California either more or less attractive for P3 investors don't vary significantly, as the investor community is international and follows standards informed by global best practices. In other words, there are few unique considerations for foreign investors that do not also apply to domestic ones, with the possible exception of cross-border currency risk and tax issues that would only be relevant to foreign investors.

The one policy factor that may relate uniquely to overseas investors is the potential for an adverse reaction to foreign ownership and operation of core domestic assets. This is unlikely to be a concern in the vast majority of P3 cases, however, and foreign ownership has not surfaced as an issue in recent projects in Florida and Virginia. Were it to be a concern, this issue is resolvable through a well-thought-out public outreach and education program, together with appropriate contractual structures and arrangements (e.g., by participating as a limited partner in a General Partner-led consortium that aggregates commitments from a diverse set of investors).

The most significant issue for a sovereign wealth fund may be its country of origin. Mitigation of this possible concern is addressed in the discussion of public education and risk management below. In general, pension funds may be publicly perceived as a less controversial source of foreign investment than sovereign wealth funds.

While similar to other investors, the perspective of overseas investors is important, however, due to the added political risk they will assume on entering a new and undeveloped California market characterized by a minimal P3 track record and uncertain processes for P3 project implementation. This is largely a question of clarity and transparency in the State's policies and administrative processes. It is noteworthy, for example, that of six major Spanish firms that could potentially bid on major P3 projects in the state, only one has committed to a presence in California. This is largely due to skepticism regarding whether the state will present viable

projects, and whether the potential reward will justify the investment of effort required. This contrasts with the experience of the Florida Department of Transportation, which has an established P3 unit that has already executed multiple deals, with a high degree of transparency (so less political risk).

California's process particularly differs from other jurisdictions such as Florida due to perceived uncertainty regarding who is ultimately in charge (e.g., CalTrans, the California Transportation Commission, or local partner agencies). Moreover, provisions in SB 4 requiring a public hearing and referral to the legislature for review and comment raise the prospect of political intervention, even if alignment with local agencies is secure, and the possibility that this might occur late in a project's development. Continued opposition by public employee unions is an additional complication.

A further uncertainty in California and the U.S. in general, from a foreign investor's perspective, is the relative lack of experience with turnkey (Design-Build) construction delivery methods, since U.S. construction companies are more accustomed to working in construction management roles. Add to this the fact that the U.S. is coming late to the global P3 market, and California faces a greater challenge.

These uncertainties muddy California's prospects, as California projects compete for investor attention and a limited pool of finance with projects in other U.S. states (e.g., Florida, Virginia, Texas, and Arizona) and in countries such as the United Kingdom, France, Spain, Canada, Ireland, India, and Australia.

### ***General Investment Considerations***

Overall, a state's competitiveness for P3 investment from any source will turn on three major factors: (1) the design of its administrative structure and processes for managing the full range of elements inherent in P3 project delivery; (2) conditions in the state's broader economic environment that make it an either more or less attractive place to invest; and (3) with regard to the specific projects the state is bringing to market, whether the revenue streams they generate are sufficient to attract and support private funding. The first factor concerns the state's regulatory framework and

the management capacity of its public agencies to plan, administer, and execute P3 programs. The second factor most often concerns cost factors that influence the investment climate in general (such as CEQA compliance) and can impact a project's anticipated rate of return. The third factor goes to the scale and quality of the project mix a state can offer. Based on these considerations, California will be at either a competitive advantage or disadvantage relative to other domestic and overseas jurisdictions that are also seeking P3 investment.

International experience points to a number of specific factors that will either enable a successful P3 program or undermine it. These can be grouped in three broad categories:

1. An unambiguous *political commitment* by the jurisdiction to the P3 process, including an articulated *vision* and acceptance by major stakeholders:

This connects to the question of political risk and the likelihood that the P3 process will be sustained over time and allowed to operate without unwarranted interference or obstruction. One indicator of that commitment and the viability of a jurisdiction as a P3 market is the evolution of a critical mass and pipeline of P3 projects.

- P3 should be recognized as an integral element of the jurisdiction's policy agenda, backed by a long-term vision and a roadmap to achieve it.
- The project pipeline should be robust, with projects of significant size and a continuity of activity over time, to ensure repeat bidding opportunities that increase the likelihood of success over time, providing bidders with a reasonable likelihood of recouping pursuit costs.
- The P3 program should be broadly supported by stakeholders including government, the private sector, and the general public. User satisfaction is an important component.

2. *An effective framework for governance*: At a minimum, this requires a robust institutional framework and administrative capacity reflecting a fair, balanced and timely procurement and management process with transparent models and standards for project selection.
  - A clear and consistent legal framework is essential.
  - The standards and processes for project selection should be clear and rigorously conformed to.
  - Institutional roles and responsibilities should be clear.
  - A balance should be set between centralized control and flexibility to address local needs.
  
3. *Strength in execution*: This requires project plans with a well-considered formula for risk-reward allocation between public and private sector entities, and transparent tender and feedback processes that minimize the likelihood of future disputes or conflict.
  - Underlying projections (time, cost, revenue) in project business plans should be robust.
  - Alignment of stakeholders around the tender process is necessary.
  - Standardization of documents, with customization as necessary, contributes to a tender process that is consistent, timely, and cost-effective. (British Columbia offers a good model.)
  - A project feedback process should link performance with incentives and provide for remedial action where necessary.
  - P3 projects are long-term contractual commitments in a fast-changing world. Project agreements should have mechanisms for public-private

benefits sharing that facilitate adjustments where necessary and provide private sector partners with continuing incentives to increase value and/or reduce costs.

- A process to capture lessons learned from executed P3 projects can enhance future success.

For a program to begin, all of these elements do not necessarily have to be in place at the outset. They are important, however, to its ability to be fully successful. Existing programs in markets such as the U.K., British Columbia and Ontario (Canada) were years in the making and evolved by incorporating lessons learned from actual experience. California, as a comparatively new player, should accelerate the development of its program by benefiting from and capitalizing on this body of global experience.

## **International P3 Experience: Selected Examples**

Experience in specific global markets shows how these three major categories of enabling conditions can drive (or how their absence can inhibit) P3 investment.<sup>4</sup>

### ***Political Commitment/Vision: South Korea***

The South Korean government has made P3 a policy cornerstone by clearly stating that outside investment is needed to build logistical infrastructure and advance South Korea's development. Government construction and transportation ministries have been specifically tasked with promoting P3 to private investors. The Act on Private Participation in Infrastructure (PPI) of 1998 laid out investment terms, incentives and other policies; allowed for the adoption of unsolicited projects; and established the Private Infrastructure Investment Center of Korea (PICKO) as a one-stop shop for developing P3 infrastructure projects. Also, when free economic zones (FEZs) were established in 2003, foreign investment in infrastructure was identified as an early goal. South Korea's 10-Year PPI Plan establishes a framework for evaluating candi-

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<sup>4</sup> The examples cited in this section are drawn from a 2009 analysis by McKinsey & Company, *If You Build It They Will Come — A Guide to Attracting PPP Investors*.

date projects, principles for project selection, and sector-specific criteria; is reviewed every three years to account for changing conditions; and is supplemented by a more detailed annual PPI plan.

### ***Political Commitment/Vision: United Kingdom***

As discussed in the Economic Institute's 2006 analysis, the U.K. offers the most highly developed model for P3 development and deployment, including the solicitation of external advice on best practices, the development of a strategy, the establishment of organizational structures, the rollout of standard contracts, the introduction of the Public Sector Comparator (PSC), and the establishment of the Gateway Process for project evaluation.

Originally developed under Conservative Party leadership, the P3 model was embraced and advanced by Britain's Labor government in 1997 to address chronically low levels of investment in public infrastructure, including education and health. This came with a strong political commitment from the Prime Minister, a coordinated strategy with regional governments across the U.K., and the identification of potential projects across all major government departments (education, health, transport and defense). A Treasury task force under the City of London was created to improve government competence, followed by the establishment of Partnerships UK in 1999 to drive best practices and advise government departments on using P3 methods. Periodic government publications have focused on process improvement and have helped sustain momentum. Most recently, the incoming (Conservative) government in the U.K. has reaffirmed its commitment to the P3 model.

### ***Political Commitment/Project Pipeline: United Kingdom***

Implementation of best practices, process improvement methods, and other measures at the outset of the program, as well as the ability to make necessary adjustments based on experience, has helped produce a sustainable deal flow over time. More than 400 P3 projects are currently operational in the U.K. The pipeline for the transportation sector is valued at \$27 billion, accounting for 37% of total planned



investment. At least one major transportation project was signed every year between 1995 and 2005 (though year-to-year flow has been cyclical, peaking in the strong economy of 2000 and falling off more recently with the global recession).

***Political Commitment/Public Perception: United Kingdom***

The pipeline for P3 projects is made transparent through the official publication of tenders and by public access to a user-friendly, comprehensive public data base of executed, ongoing and planned P3 projects. Public satisfaction with P3 is generally positive, despite lingering concerns over private sector profits, the perceived privatization of public services, and some instances of lower than expected service quality.

***Effective Governance/Legal and Institutional Frameworks:  
United Kingdom, Australia, Mexico, India, France***

Stability is essential to P3 frameworks, which should be subject to only minor amendments over time. Different countries may have requirements that relate to the specific demands of their economic or policy environments. Airports, which are monopoly assets, offer some examples: airport user fees may need regulation (U.K., Australia, Mexico); India (which urgently needs new airport capacity) provides a 10-year tax moratorium on airport profits for private concessionaires. An example of evolutionary adjustments is France's passage of legislation (the Partnership Contract Edict) to eliminate barriers in the Public Procurement Code that inhibited more robust P3 investment. The changes included eliminating a prohibition on availability payments, and eliminating a requirement for separate tenders for Design-Build (DB) and Operate-Maintain (OM) contracts, thereby permitting classical DBFOM (Design-Build-Finance-Operate-Maintain) projects.

***Effective Governance/Clear Parameters, Transparency, Standardization:  
South Korea, United Kingdom***

South Korea's 10-Year PPI Plan provides guiding principles and criteria for project selection (e.g., financial rate of return based on average cost of borrowing, risk premium, and rate of return in other countries competing for investor funds).

Key procedural requirements are defined in the Private Finance Initiative (PFI) Act. PICKO (Private Infrastructure Investment Center of Korea) facilitates the project administration and evaluation process following procedures established in the Act. PICKO assigns an evaluation team to each project, including designated experts where needed. While South Korea's model for P3 project selection is standardized, it allows for diverse formats (Build-Operate-Transfer, Build-Lease-Transfer, etc.)

In the United Kingdom, individual departments are responsible for managing their own proposals. All proposals are subject to the Gateway Process, overseen by the Office on Government Commerce, which assesses project viability on six levels: strategic assessment, business justification, procurement strategy, investment decision, readiness for services, and delivery of benefits (value-for-money). The Public Sector Comparator (PSC) is used as a standardized tool to specifically measure the value-for-money element of proposed P3 projects. Guidelines are also provided for the appropriateness of P3 for specific project categories (e.g., greenfield versus brownfield).

### ***Effective Governance/Clear Institutional Roles: South Korea, United Kingdom***

In South Korea, P3 governance centers on PICKO, which is responsible for overall P3 administration, including feasibility studies of solicited projects, handling of unsolicited projects, negotiation of concession agreements, promotional activities, and intergovernmental liaison. PICKO also runs educational programs for civil servants, financial institutions, and private sector personnel, and it conducts studies on how to improve P3 policies.

In the United Kingdom, P3 is driven by Partnerships UK, which anchors government activity, defines standards, consults with and supports public bodies in support of the government's P3 plan, and provides practical expertise in the execution of P3 projects. The organizational framework of Partnerships UK includes 60 P3 experts with public and private sector backgrounds, a board of directors with a private sector majority, and an advisory council. Equity holders include the Treasury, the Scottish Ministry, and ten U.K. financial investors and service providers.

***Execution Strength/Robust Business Plans and Clear Risk Allocation:  
United Kingdom***

The United Kingdom recognizes that cash flow projections should be supported by valid and transparent underlying assumptions. In greenfield projects, for example, traffic and volume projections must be as accurate as possible. Any project risk related to government activity should be clear up front (e.g., changing laws or the possibility of the government building competitive infrastructure in the future).

***Execution Strength/Alignment of Stakeholders and Transparent Tender Procedures: France, Netherlands, Mexico***

Failure to align major stakeholders around the tender process can delay or scuttle projects, as happened when local resistance stalled the Turin-Lyon high-speed rail tender, and when a maglev tender in the Netherlands was withdrawn due to political uncertainty.

Unnecessary barriers to bidders (e.g., excessive technical and legal qualification requirements) should be avoided, as should discrimination between foreign and domestic bidders. Clear and transparent procedures can also help protect against litigation. These issues are exemplified by a recent 75 km road project in Mexico (CONIPSA), where the progress was delayed by a tender process that was considered expensive and non-transparent, and multi-year budgeting with a requirement for Congressional approval added political uncertainty and complicated the negotiation of payments.

***Execution Strength/Effective Control and Feedback Systems:  
United Kingdom***

At the system level, the U.K. Treasury plans and coordinates monitoring of all P3 activity. Partnerships UK and the National Audit Office survey the government, the private sector, and the public to assess project efficiency and satisfaction with services, and can recommend systemic changes. Departmental Private Finance Units

(PFUs) monitor projects under their responsibility. PFU and central government projects are subject to “benefits evaluation” under the Gateway Process that monitors compliance with the initial business case. Government departments are responsible for disseminating best practices, and project selection processes are subject to subsequent reforms.

### ***Validation of Findings***

A 2009 study by the U.S. Department of Transportation’s Federal Highway Administration (FHWA), *Public-Private Partnerships for Highway Infrastructure: Capitalizing on International Experience*, broadly validates these findings. The analysis is based on a survey by the FHWA of P3 programs for highway infrastructure development in Australia, Portugal, Spain and the United Kingdom—countries with more extensive P3 project experience than the United States. Given its exclusive focus on transportation, the study’s conclusions—which identify a number of characteristics of successful P3 programs based on international experience—are relevant for California state agencies and the PIAC.

## **Closing the Deal: Incentivizing P3 Investment in California**

### ***Market Scale***

One factor works to California’s benefit as a destination for foreign investment: the extraordinary quality and scope of California’s economy, measured both by national and international standards. Here the state is particularly well positioned, with an economy of global scale and an affluent population of 37.5 million consumers.

With regard to P3 investment specifically, California presents overseas investors with a major market opportunity. As also detailed at the start of this paper, California’s needs rival and surpass the vast majority of economies around the world, with an infrastructure backlog totaling as much as \$530 billion in investment in the next 10 years.

## ***Incentivizing P3 Investment in California***

For California to compete effectively for P3 investment from any source, foreign or domestic, it must meet or exceed global standards of excellence for P3 administration and management. In this context, the following threshold issues must be addressed:

- ◆ The public sector's policy/management framework;
- ◆ The roles of private versus public tax exempt financing; and
- ◆ Project viability and the risk-return ratio for greenfield investing.

Questions regarding California's emerging P3 framework primarily revolve around the clarity and transparency of the public sector's governance framework and the state's capacity as a counterparty to private investors.

These issues can be addressed—and P3 investment in infrastructure increased—by movement to:

1. **Build Credibility through a Project Pipeline.** This would attract more and larger players and enhance competition in the P3 market. While the PIAC is focused on transportation, a broader P3 program could start with smaller projects in non-transportation areas with clear needs and potentially strong public support—such as education and hospitals—and build the case from there. The fact that non-transportation projects typically involve availability payments, as opposed to user fees, may reduce their political complexity. (Transportation projects tend to be more complex due to user fee issues.) In the U.K. and Ontario, for example, relatively few P3 projects have been in transportation. A number have been in education, facilitated by a more centralized government structure than in California and the U.S. For transportation projects—the focus of SB 4 and a more complex arena—starting in California with a small number of successful, well-managed pathfinder projects may offer a better course than a broad, large-scale launch. Ideally, this could begin with relatively simple, straightforward projects, allowing

government agencies to build from there. This should be followed by measurement and assessment of progress and performance in project execution.

2. **Change the Procurement Culture.** Moving towards an outcome-based culture that values improved timing and life cycle cost savings requires a willingness by the public sector to shift from input-oriented to output-specified procurement, enabling private partners to develop the most efficient and effective means to achieve government-specified objectives (as opposed to government-specified methods for achieving stated objectives).

The relative merit of tax-exempt bond financing also needs rethinking. As this is a comparatively new field, public employees and officials may lack knowledge and experience regarding global best practices in infrastructure procurement, and may be unfamiliar with funding mechanisms that don't rely solely on traditional tax-exempt bonds. Agency-level education and support could prove useful. Project level analysis using a Comparator will likely show that in many cases the 15%–30% life cycle cost savings available through P3 exceeds the advantage provided by the typical 1%–1.5% funding cost differential available through tax-exempt funding. This also suggests the potential value of developing a Comparator as a tool for updating the procurement process.

3. **Formalize a Center of Expertise.** Few, if any, successful P3 programs around the world have advanced in the absence of well designed and organized government resource centers. On the other hand, there are many well-established models that share common success factors including:
  - A degree of independence from the established procurement environment, facilitating a mix of old and new methods;
  - Adequate resources, noting that most programs use a combination of staff (internal resources) and external bankers, consultants, engineers, and contractors as contributors; (at its inception, for

example, Partnerships UK was a 50/50 joint venture staffed and funded by both the public and private sectors);

- Well defined, transparent procurement processes;
- A strong orientation toward meeting well-thought-out performance goals and metrics, with the public sector demonstrating that it has the knowledge and expertise to make informed decisions in a timely manner;
- A commitment to open performance reviews and feedback from all participants in the process;
- Both the breadth and sector-specific capacity to bring focus to the incipient P3 market and support public agencies in their negotiations with private sector partners.

Since California's budgetary situation makes it difficult to fully fund the center of expertise from public resources, consideration could be given to making the center self-funding. While a clear connection to the services provided would be necessary, this could be done through fees levied against successful projects.

- 4. Address Appropriations Risk Concerns.** To ensure that bid packages include fully committed financing, potential banking community concerns regarding the ability of state entities to support P3 project commitments should be addressed. This has to do with the ability of the state, through its agencies, to fulfill its commitments and, more specifically, funding sources and payment mechanisms (e.g., where in the budget the payment sits, and whether or not it is subject to an annual legislative appropriation). Financial transparency in the procurement process can help address these questions. It is also important to investors that the state's financial position not be deal-specific or renegotiated in each transaction, as the absence of a systemic framework adds significantly to time and costs for sponsors.

Looking to global practice in this area, British Columbia provides a provincial guarantee, and Ontario includes the provincial Ministry of Finance as a co-sponsor of its projects, alongside the primary sponsoring ministry.

- 5. Ensure Timely and Detailed Information to Bidders.** This should include transparency and specificity regarding the criteria by which bids will be evaluated. In the Long Beach Courthouse bid process, for example, four overall categories for evaluation were established (e.g., Design, Construction) with a total score for each category. Absent more granular information for bidders, the integrity of the process may be questioned by the market and the quality of submittals negatively impacted.

Market confidence will also be enabled by rigor and transparency in RFP procedures. For example, in some jurisdictions it is standard practice to release draft documents for comment to shortlisted bid teams prior to release of the final RFP and the formal commencement of the bid process. Such procedures can provide an opportunity to address threshold issues such as appropriations risk, bid evaluation, and other terms in a manner that strengthens confidence in the process and saves bidders time and expense.

- 6. Address Private Sector Transaction Costs.** As procurement processes can be lengthy and expensive, unsuccessful bidders could be offered a stipend for pursuit costs, to be incorporated into total capitalization by the successful bidder. Canada, for example, pays stipends to losing bidders; in Quebec this can be up to 100% of bid costs. This approach has also been followed in Oregon.
- 7. Draw on the Experience of Other States.** A process should be considered for sharing regulatory experiences and lessons learned among states with active P3 programs such as Florida, Illinois, Texas, Virginia, and New York.
- 8. Improve Federal, State and Local Coordination Between Public Funding Sources.** The withdrawal of federal stimulus funding in 2010 for the BART-Oakland Airport Connector project is an example of a costly disconnect.



In any context, including but not limited to P3 applications, multi-party financing is the commonly accepted practice outside the U.S. and can be seen in larger projects in the U.S. over the last 18 months. The Miami Tunnel, Florida's I-595, Virginia's I-495, and the Texas LBJ Hot Lane Project all incorporate multiple tranches of public and private capital, including a tranche of TIFIA funding. This emerging multi-party finance framework should be incorporated into project funding strategies at an early stage. Specifically:

- Multi-tranched capital structures and multi-party transactions are inherently complex, requiring a high level of contractual, legal, financial and operational competency. California needs to develop the necessary advisory and legal resources to play in this market, drawing on both transactional experience and educational programs.
- The Center of Expertise should be able to effectively act as an agent in coordinating the resources required to support transactions.
- California should consider supporting the creation of a National Infrastructure Bank (or Fund) that is capable of rivaling the effectiveness of similar institutions elsewhere in the world such as the EBRD and EIB in the EU. Related considerations include TIFIA reform and the need to delve into federal scoring and appropriations models to better understand how credit guarantees, credit wraps, loans, subordinated debt, equity in lieu of grants, and other structures can benefit a wide range of projects. Looking to the government as solely a grantor or lender falls short of the more creative and impactful solutions now in play around the world.

**9. Review Conflicting Laws, Regulations, Policies and Departmental Jurisdictions That May Impede Timely and Effective Implementation.**

The creation of standard form documentation should be considered. The California State Bar Association Subsection on Public Private Infrastructure

could be invited to lead this effort. Though there is some risk that this could introduce additional complexity, the State could also consider creating the position of “Fairness Adviser.” Pioneered in Canada and the U.K., the role of the Adviser, who is present for all negotiations, is to ensure that bidding rules are followed precisely and the playing field is level. Appointment of a Fairness Adviser could facilitate the process by enabling private sponsor-bidder exchanges in a format that ensures balance and transparency, and protects privileged bidder information.

**10. Involve California’s Pension Funds.** California is home to some of the world’s largest public pension investment funds. The engagement of these funds in P3 projects in the state would both send an important signal to the global investment community and increase the engagement and awareness of public employees in the P3 process.

**11. Engage Labor as a Partner in the Infrastructure Asset Formation**

**Process.** Labor has been an important partner in the implementation of P3 programs elsewhere in the world. After initial resistance, there are many successful examples of projects where labor has been a vital and important constituent in the process. Reaching this level of concord has proven difficult in California, however, particularly where public sector unions are involved. It would be beneficial to the state and its economy for unions and project sponsors to seek alignment around the opportunity for increased project activity, and for unions to become direct stakeholders in P3 projects through their pension funds, as has happened in the U.K. (where, for example, the Ontario, Canada teachers pension fund is a major investor).

**12. Invite the Private Sector to Engage Earlier and More Directly.** For example, subject to the governance and VfM-based selection processes applicable to all P3 projects, unsolicited proposals (which are already authorized under SH 143) could be explicitly encouraged.

**13. Engage Early Regarding CEQA.** The California Environmental Quality Act (CEQA), enacted in 1970, has as its goal the evaluation and mitigation of the environmental impacts of all development proposals and projects in California, public or private, which are regulated by public agencies. There is considerable uncertainty in the CEQA process, caused by the flexible and vague standards regarding its objectives. The language for such key standards as determining the “significance” of effects to be mitigated, and for determining what constitutes an appropriate mitigation, was left purposely vague. These features of the law can be problematic for development as vagueness “provides would-be petitioners with footholds to challenge projects.” One of the major consequences that arises from this inconsistency and vagueness is that project applicants and lead agencies must attempt to “bullet-proof” EIRs against lawsuits, generating extensive and redundant documentation.<sup>5</sup>

The broader question of CEQA reform aside, this suggests that in order to effectively manage the important crosscutting public policy goals and objectives of VfM and CEQA, additional focus is required to ensure that public department heads and finance professionals can effectively implement P3 projects consistent with CEQA’s requirements. Specifically:

- CEQA design requirements should be appropriately represented in the project Request for Quotation (RFQ) or output specifications for P3 projects. For example, a road contractor responding to an RFQ for a transportation system should be challenged by the RFQ to utilize the best available design, engineering, investment, and construction methods to ensure that the appropriate CEQA goals and objectives are being met. Early identification of these issues enables project participants to get a head start in resolving CEQA requirements.

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<sup>5</sup> Elisa Barbour and Michael Teitz, “CEQA Reform: Issues and Options,” Occasional Paper (San Francisco, CA: Public Policy Institute of California, April 2005).

- To ensure VfM, expedited CEQA review should, as far as possible, ensure that CEQA requirements are satisfactorily resolved within the same time frame as the investment decision.
- Additional clarity is needed regarding the proper timing of CEQA review in P3 projects. The court's recent Save Tara decision has called into question the ability of agencies to make preliminary legal commitments to projects prior to conducting a full environmental review. For agencies lacking resources, this may be a significant obstacle. Since a certain amount of preliminary engineering is often needed when preparing environmental documents, requiring a full CEQA analysis prior to advertising a P3 project may result in the project gaining significant momentum as a conventional procurement, undercutting the P3 potential due to the loss of momentum in the bidding process.

For the most part, CEQA isn't a major obstacle to P3 investment, as investors will typically look to the partner public agency to ensure that a project's EIR is in place. However, the potential risks and delays inherent in CEQA can, particularly in the design and build-out phase, add uncertainty and complexity to the process. For example, agencies such as CalTrans have little experience with the Design-Build process or with the cost sensitivities associated with P3 projects and the implications of delay in design approval on project viability. The group that approves the design for compliance with the environmental permit (regarding mitigation) may be different from the group that approves the design for compliance with CalTrans engineering standards and specifications. The CEQA process would benefit from review with an eye to improving efficiencies and reducing risks.

**14. Address Other Factors That Drive Up Costs.** Another factor that can negatively affect California's appeal to investors is its high cost structure, particularly in the construction phase, based in part on the time required to get

projects sited, permitted, safety-approved, environmentally assessed, and inspected. The resulting cost overruns can impact a project's risk-return ratio and bottom line. Assessing these barriers and, where possible, streamlining regulatory processes would benefit the P3 process.

**15. Reform the Infrastructure Finance Act (Government Code 5956).**

The legal structure of the Infrastructure Finance Act contains a number of provisions that limit its utility. Issues include a 35-year limit on any project, a requirement for 100% surety bonding, limits on the use of tolls or fees, and the absence of an exemption from property taxes.

**16. Engage California Citizens.** California citizens and voters need education on the costs and benefits of infrastructure and the financing constraints and opportunities available to the state. Citizens need to understand and pay the full-freight costs of the infrastructure they use.

While many of the suggestions detailed above will require further debate and analysis, progress on the key issues enumerated in this section will significantly improve California's attractiveness as a location for both domestic and international P3 investment.

## **Conclusion**

Ultimately, California must decide how to connect its infrastructure requirements with what private investors are willing to finance and build. In the end, this must happen through implementable transactions. In part, this is an issue of marketing and perception, as California competes for investment globally. More critically, this presents a policy and management issue relating to the ability of the state's administrative process, at all levels, to meet global P3 standards. Those standards are common to all jurisdictions, in the U.S. and overseas, and to all investors, whether they are domestic or international. A process that shows that the public sector knows what it wants, knows how it is going to get it, has clear rules for engagement, has a funding strategy, and can effectively allocate risks and rewards

will enable both domestic and overseas boards of directors to more easily make investment decisions in California's favor.

To successfully attract infrastructure investment on a large scale, California must also offer a critical mass of bankable projects that meet competitive national and global risk-reward standards. The potential scale of California's infrastructure market is perhaps its greatest advantage in the global competition for P3 investment. Continued uncertainty surrounding the institutional strength and future direction of California's P3 program is perhaps its greatest weakness and competitive disadvantage. Maximizing that potential to deliver the highest value and service to California and its citizens will require sustained commitment to a transparent, efficient, and stable P3 process and the development of an early portfolio of successful projects that will demonstrate to domestic and overseas investors the political commitment of the state and the efficacy of its procedures.

## Appendix

**AB 680 (Streets and Highways Code 143)** was signed into law by Governor Deukmejian on July 10, 1989. At that time, the Legislature declared an urgent need in the state for supplemental sources of funding for state transportation projects. “Public sources of revenues to provide an efficient transportation system have not kept pace with California’s growing needs, and alternative funding sources should be developed to augment or supplement available public sources.” [1989 Cal. ALS 107 § I] The gravity of the issue further compelled the Legislature to declare SH 143 an urgency statute necessary for the immediate preservation of the public peace, health, or safety in connection with the state’s transportation program. [1989 Cal. ALS 107 § 3]

As originally enacted, SH 143 authorized the California Transportation Department to enter into agreements with private entities for construction of four transportation demonstration projects. [Streets and Highways Code § 143 (1989); Cal. ALS 107 § 2] To facilitate these demonstration projects, SH 143 provided that agreements between the government and a private developer “may include provisions for the lease of rights-of-way in, and airspace over or under, state highways, for the granting of necessary easements, and for the issuance of permits or other authorizations to enable the private entity to construct transportation facilities supplemental to existing state-owned transportation facilities.” [Streets and Highways Code § 143(b) (1989); Cal. ALS 107 § 2] The statute provided that the Department “may exercise any power possessed by it with respect to the development and construction of state transportation projects to facilitate the development and construction of transportation projects pursuant to this section.” [Streets and Highways Code § 143(c) (1989); Cal. ALS 107 § 2] Lastly, the statute provided that agreements shall authorize private entities to impose tolls for the use of a facility, and that such tolls be applied to pay, among other things, the private entity’s capital outlay costs for the project. [Streets and Highways Code § 143(d) (1989); Cal. ALS 107 § 2]

Minor amendments to SH 143 were made in 1990 and 2002. Substantive changes to the statute were made in 2006 through a reenactment effective January 1, 2007. Those revisions included a new definition of “transportation project” that closely

parallels the definition in the current statute. “Transportation project” means one or more of the following: planning, design, development, finance, construction, reconstruction, rehabilitation, improvement, acquisition, lease, operation, or maintenance of highway, public street, rail, or related facilities supplemental to existing facilities currently owned and operated by the department or regional transportation agencies.” [Streets and Highways Code § 143(d) (2007)] The 2007 enactment authorized four additional transportation projects, two in northern California and two in southern California, to the extent that agreements for such projects were entered into prior to January 1, 2012.

**SB 4.** The current version of SH 143 was reenacted by the Legislature (sitting in emergency session) through SB 4, and signed into law by Governor Schwarzenegger on February 20, 2009. The statute contains comprehensive rules and procedures required for development of public-private partnership projects and, through the revisions, was intended to bring California’s public-private partnership program in line with programs adopted by other states and throughout the world. The statute authorizes construction of an unlimited number of projects approved by the California Transportation Commission through a sunset date of January 1, 2017.

Reenactment of Streets & Highways Code § 143 (SB 4) also created the Public Infrastructure Advisory Commission (PIAC) to perform the following purposes articulated in the statute:

- A. Identify transportation project opportunities throughout the state.
- B. Research and document similar transportation projects throughout the state, nationally, and internationally, and further identify and evaluate lessons learned from these projects.
- C. Assemble and make available to the department or regional transportation agencies a library of information, precedent, research, and analysis concerning infrastructure partnerships and related types of public-private transactions for public infrastructure.



- D. Advise the department and regional transportation agencies, upon request, regarding infrastructure partnership suitability and best practices.
- E. Provide, upon request, procurement-related services to the department and regional transportation agencies for infrastructure partnership.

**Government Code Section 5956.** In enacting Government Code § 5956 et seq., the Legislature declared, “Local governmental agencies have experienced a significant decrease in available tax revenues to fund necessary infrastructure improvements. If local governmental agencies are going to maintain the quality of life that this infrastructure provides, they must find new funding sources. One source of new money is private sector investment capital utilized to design, construct, maintain, rebuild, repair, and operate infrastructure facilities.” [Gov. Code § 5956] “It is the intent of the Legislature that local governmental agencies have the authority and flexibility to utilize private investment capital to study, plan, design, construct, develop, finance, maintain, rebuild, improve, repair, or operate, or any combination thereof, fee-producing infrastructure facilities.” [Gov. Code § 5956.1]) Government Code § 5956 et seq. is subject to two significant limitations. First, neither the state nor any state agency may directly or indirectly use the authority under the statute. [Gov. Code § 5956.10] Second, no government authority may use the statute to design, construct, finance, or operate a *state project*, specifically including toll roads on state highways, state water projects, state park and recreation projects, and state financed projects.

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## **Bay Area Council Economic Institute**

The Bay Area Council Economic Institute is a public-private partnership of business, labor, government and higher education that works to support the economic vitality and competitiveness of California and the Bay Area. Its work builds on the twenty-year record of fact-based economic analysis and policy leadership of the Bay Area Economic Forum, which merged with the Bay Area Council in January 2008.

The Association of Bay Area Governments is a founder and key institutional partner. The Economic Institute also supports and manages the Bay Area Science and Innovation Consortium (BASIC), a partnership of Northern California's leading scientific research institutions and laboratories. Through its economic and policy research and partnerships, the Economic Institute addresses major issues impacting the competitiveness, economic development and quality of life of the region and the state, including infrastructure, globalization, science and technology, and governance. Its Board of Trustees, which oversees the development of its products and initiatives, is composed of leaders representing business, labor, government, higher education, science and technology, and philanthropy.

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