Bond Case Briefs

Municipal Finance Law Since 1971

GFOA Alert: Public-Private Partnerships (P3).

GFOA Advisories identify specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

Background:
Public Private Partnership (P3) Agreements are complex arrangements that use public and private sector resources to accomplish a stated goal. Many organizations have used P3 agreements successfully to gain access to capital, develop capital assets, provide services more efficiently, or provide large infusions of cash to help fund other organizational priorities. However, P3 agreements also contain varying degrees of risk, and some organizations have pursued projects that have been controversial and detrimental to the short-term and long-term fiscal health of the public sector entity. P3 agreements can leave the public entity exposed to fiscal and/or political fallout if proper due diligence does not occur, the private partner fails to perform, or if expected project outcomes do not happen. Careful planning and analysis is necessary with every P3 project. GFOA has developed resources for approaching P3 agreements in a structured way that mitigates risk and improves prospects for long-term success.

Recommendation:
Organizations, and especially the finance officer, must understand what is at stake and make informed, strategic decisions on whether or not to pursue P3 opportunities. Finance officers should be involved throughout the process of a public entity's consideration of potential P3 opportunities. Not fully understanding the overall financial implications, including what the public entity may forfeit, can result in P3 agreements that may not serve the public interest or be detrimental to the long-term financial health of the organization.

Before deciding to pursue or enter into a P3 agreement, the public entity should carefully analyze the potential P3 agreement, including all financial impacts. The list of key considerations below has been developed to help the public entity decide whether or not to pursue a P3 opportunity.1

1. Legal Authority of P3. Does the public entity have the legal and regulatory capacity, including approval from any applicable oversight body, to enter into processes that result in a P3 agreement? Also, does the public entity's contracting/procurement policies or requirements provide for how to handle the proposed P3?
2. Justification for the Project. Does the project address a public priority and is the P3 project consistent with the overall strategic, master plans and financial policies of the organization
3. Competition. Will the potential P3 opportunity be open to competition? What is the expectation for competition in determining the best private partner? Otherwise, is there justification to support a non-competitive process? Also, has the financial, risk and legal analysis of the project been compared to a public-sector alternative?
4. Expected Project Revenue. If the P3 opportunity involves an upfront payment by the private partner in exchange for operation of a public asset, has the public entity evaluated and prioritized how to use project proceeds?

5. Independent Analysis. Has the public entity or an independent third party analyzed the P3 opportunity to verify revenue projections, demand and other assumptions used in the P3 evaluation?
6. Method for Performance Monitoring. Is there a proper management structure in place and within the proposed agreement in the event that anticipated/expected results are not achieved? How will performance be monitored against expected results and who will have this responsibility? Will there be check-in milestones, executive reporting and service-level targets in place to monitor and report performance of the project?
7. Flexibility During the P3 Term. Does the expected term of the P3 agreement limit the public entity's flexibility in responding to changing demographics or other circumstances? Does the P3 agreement limit the public entity's flexibility to make certain decisions about service provision in the future. Does the public entity have the ability to renegotiate the agreement?
8. Project Risks. Are project risks and risk transfer elements clearly articulated and understood by all key stakeholders? Is the public entity responsible for any costs should the private entity not perform?
9. Transaction Costs. Does the project proposal contain a comprehensive and realistic statement of transaction costs? Do expected transaction costs limit project benefits? Often, for smaller organizations and smaller projects, the time and costs associated with negotiating and finalizing a P3 agreement can limit the potential benefits from the project.
10. Bond Rating Impact. What are the potential positive or negative bond rating impacts on the public entity? Are municipal payments treated as operational expenses or debt service in a flow of funds?
11. Public Participation and Disclosure. Have appropriate public outreach mechanisms (such as community meetings, informational newsletters, and other communications or actions as may be required by law) been met to provide transparency and feedback?
12. Availability of Assistance. Do external resources such as professional associations, state agencies or non-profit organizations exist to support and assist the public entity with the consideration, process and/or drafting of the agreement? P3 agreements are typically complex and will require access to specialized financial, legal or technical skill sets. Many smaller governments may also lack the resources necessary to ensure adequate, independent analysis and due diligence when evaluating potential opportunities.

Committee:
Economic Development and Capital Planning

Notes:
1 Note: this list is not intended to serve as a comprehensive analysis of all P3 terms and features, but as a listing of common risks and areas of focus.