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A 5-Part Test for Public-Private Partnerships.

Like it or not, public-private partnerships (P3s) for infrastructure are here to stay in the United States. The recent openings of two Florida projects, the I-595 Express highway and the PortMiami Tunnel, as well as Texas' North Tarrant Express highway — projects with a total cost of $4.9 billion — are high-profile success stories that provide a demonstrable proof-of-concept boost for the U.S. P3 market.

But P3s have not fared well in some places. The Philadelphia City Council, for example recently refused to vote on Mayor Michael Nutter's proposal to sell the antiquated Philadelphia Gas Works to UIL, a publicly traded company, for $1.86 billion. The failure of that transaction and earlier P3 proposals such as those involving the Pennsylvania Turnpike and Chicago's Midway Airport raise a fundamental question. What does it take for a P3 to succeed and reach the public-policy finish line?

Whether one is an official aspiring for the best deal for the taxpayers or a vendor trying to decide whether to invest millions of dollars in a P3 bid, there are principles that can provide guideposts. We suggest the following five conditions as a recipe for success:

1. Political will: Fundamental to any successful P3 initiative is broad-based, senior-level support within a government. If a jurisdiction is divided on partisan or other lines as to whether a P3 is the correct approach, it reduces both the chances of success and the vendor's appetite to present a financially attractive proposal. Without a real consensus at the outset, the risk of a P3 being thwarted or mischaracterized by opponents is simply too high. Dealing with the politics at the beginning of the process, not the end (as happened in Philadelphia), ensures that a government does not waste bidders' time or its own.

2. A belief in private-sector value creation: Philosophically, there has to be an embrace of the idea that the private sector can create value that government cannot achieve on its own. In advising a major U.S. city, a senior official once stated that "a contractor is nothing more than someone trying to get money out of the government's wallet." With any variant of this attitude — viewing a P3 partner in an adversarial way before even entering into a transaction — an initiative cannot succeed. In places as varied as Indiana and Florida, the public sector has embraced P3s because there is an underlying belief that, properly structured, they can create more value than traditional procurement approaches.

3. The underlying quality of assets: The assets involved in the P3 transaction must be of commercial interest to the private sector. This may seem basic, but there have been a number of situations where bid processes were launched involving distressed assets. A proposed lease of the Port of Chicago, which had operated at a loss for 10 years and had not seen significant investment since the 1980s, failed to gain traction in the market, for example. The takeaway: Clever public marketing can rarely overcome a difficult or unattractive business proposition.

4. Commercially reasonable contract terms: Negotiating a concession agreement or other project documents is always a balancing act. On the one hand, the public interest must be comprehensively protected. On the other, it is not uncommon to have a situation where all of the bidders object to a contract term proposed by the government, only to have their feedback ignored. When companies indicate that a contract term would prevent them from bidding, it is prudent to listen. A contract that allows multiple companies to submit final bids is critical. In its Ohio River bridges contract, Indiana got the risk allocation and other terms correct.

5. A willingness to pay transaction costs: Hiring experienced financial, legal and technical advisers is good public policy, but bringing these experts on board during the P3 process involves costs that can encounter political resistance. However, transaction costs effectively amount to a rounding error on large projects. In this regard, perhaps it wise to follow some age-old advice and avoid being penny wise and pound foolish.

Overall, it is expected that the United States will become the world's largest P3 market over the next decade. For that to happen, many successes will be needed. We believe the five-part test outlined here can be a useful filtering and decision tool for public officials evaluating P3 projects.

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