PUBLIC-PRIVATE PARTNERSHIPS IN CALIFORNIA

Public-private partnerships are used to entice the private sector to fund projects typically financed by governments, such as designing, constructing and operating freeways or other publicly-used facilities. The arrangement typically requires the private sector to provide up-front funding for a project and later earn back its investment through revenues generated by the project. A toll road is one of the most common types of public-private partnerships, with the private sector financing the construction of the road and then earning revenue from tolls paid by motorists.

Benefits of public-private partnerships. Proponents of these projects believe they provide several benefits to government, such as:

- Building projects that governments can't. By tapping into private funds, governments can build projects that would otherwise not be built due to lack of up-front public money.
- Sharing risks. An agreement between a government and private entity allows the government to share risks of the project, such as construction delays.
- Expediting projects. Projects can sometimes be completed quicker when done by the private sector.
- Improving project certainty. A public-private partnership can allow the government to have a firmer understanding of the cost of a project, as the agreement often stipulates that the government will only pay a certain amount.

Legislative history. The Legislature has sought to authorize public-private partnerships in at least three pieces of major legislation during the past few decades. In 1989, AB 680 (Baker), Chapter 107, authorized the California Department of Transportation (Caltrans) to enter into agreements with private entities to construct and operate toll roads. In 2006, AB 1467 (Nuñez), Chapter 32, allowed up to four transportation projects to be built using public-private partnerships, although the legislation required legislative approval before specific projects were built.

As part of a budget agreement between the Schwarzenegger administration and the Legislature, SB x2 4 (Cogdill), Chapter 2, was approved in 2009 to further encourage public-private partnerships. The legislation removed the requirement that the Legislature approve specific projects before they occur and also allows for courthouses, prisons and local redevelopment agency projects to be built through public-private partnerships, as well as freeways, local roads, bridges and tunnels. The legislation was introduced on Feb. 11, 2009 and signed by the governor nine days later.

Two projects completed so far. Despite years of discussion, the state has created only two major public-private partnerships. Both are toll roads in Southern California, and both have experienced major challenges but remain in use.

- State Route 91. Caltrans and the California Private Transportation Company entered into an agreement to create toll lanes on State Route 91, which connects Los Angeles and Orange counties to Riverside County. The project was completed in 1995, but became controversial due to a clause in the contract that prohibited improvements or expansions of nearby freeways to protect the toll road's profitability. With area congestion worsening, Caltrans sought to make improvements to the "free" parts of the road, which led to a lawsuit by the private company. Caltrans later settled the litigation. Due to ever-increasing congestion and rising accident rates, the Legislature authorized the public Orange County Transportation Agency to purchase the toll lanes in 2002 to help clear the way for improvement and expansion of the freeway and nearby roads. The toll lanes are now publicly-owned.

- State Route 125. A 10-mile, privately-operated toll road in San Diego County called the South Bay Expressway was opened in 2007 by Macquarie Infrastructure Group, a subsidiary of an Australian company. The road's opening was 13 months late, and due in part to the slumping economy, traffic was a third of what was originally projected, causing the project to go into bankruptcy in 2010. While the road remains open, it is unclear who will become the owner once the project emerges from bankruptcy this year.

Two other public-private partnerships - a new courthouse in Long Beach and the Presidio Parkway Project in San Francisco - are currently underway in California.

PRESIDIO PARKWAY PROJECT OVERVIEW

On Jan. 3, 2011 – the final day of Gov. Schwarzenegger's administration – Caltrans signed an agreement with a consortium of companies called Golden Link Partners to design, construct and operate a 1.6-mile stretch of State Route 101 that connects the Golden Gate Bridge to city streets in San Francisco. This is the first public-private partnership project overseen by Caltrans since the 2009 legislation (SB x2 4) sought to encourage such projects.

Currently called Doyle Drive, the road was built in 1936 with narrow lanes, no shoulders and no median. The road is seismically unsafe and its replacement is a priority for the San Francisco Bay Area. There are two phases of the project, which is called the Presidio Parkway Project because the new road will be called the Presidio Parkway. The first phase, to improve seismic safety and shift traffic to temporary roads, is underway and is being designed and built under a typical procurement process. In that process, the project is managed and designed by Caltrans, with construction firms bidding to complete the construction.

History of the project. The second phase, to replace the road with a new, permanent road, was originally planned as a traditional procurement, with a funding plan approved by the Federal Highway Administration in 2009. The second phase of the project was transformed into a public-private partnership in late 2009, however.

As required by SB x2 4, the public-private partnership concept for this project was submitted to the California Transportation Commission (CTC) for approval in 2010. The Commission approved the project on a 6-5 vote, despite a recommendation from the CTC staff to deny the project. After CTC approval, the Legislature appropriated funding for the public-private partnership in the 2010-11 Budget as part of SB 870 (Ducheny), Chapter 712.

Caltrans conducted a request-for-proposal bidding process in late 2010 and received two bids for the project. Caltrans selected Golden Links Partners in October 2010. Golden Links is comprised of several companies, including Germany-based construction firm Hochteif, and France-based Meridiam Infrastructure.

Contract costs and timeline. The project is now expected to cost as much as $1.4 billion during the life of the 33-year contract. About $1.1 billion will be paid out of the State Highway Account, which is comprised mostly of state gasoline taxes. About $300 million will come from other sources, such as $85.2 million in federal stimulus dollars and $207 million in funds from Bay Area transportation agencies.

The contract calls for the state to pay Golden Links a lump sum of $173 million, called a milestone payment, when the project is constructed and open to the public. The roadway is to be opened no later than Dec. 31, 2014. The state is then obligated to pay Golden Links an annual payment, called an availability payment, of about $28 million per year for 30 years, to operate and maintain the road, as well as pay off debt associated with the construction costs. Additional costs include transaction costs and a risk reserve. Caltrans does retain the right to withhold some of the availability payments if the contractor does not operate and maintain the road to set standards.

Numerous concerns about the project. While no one questions the need to replace Doyle Drive, several legislators, the Legislative Analyst's Office (LAO) and California Transportation Commission (CTC) staff have all raised concerns about the Presidio Parkway Project as a public-private partnership. Because there is no toll or other new revenue source that will be developed, the state will use existing State Highway Account funds to pay the private entity, essentially likening this to paying off a long-term loan.

Among the concerns are:

- ***The biggest benefit of a public-private partnership is not applicable to this project.*** Proponents of public-private partnerships argue that such arrangements help governments build projects they couldn't typically afford. This project, however, was already fully funded and underway in 2009. Phase 1 of the project was designed and bid in the traditional procurement manner, and Phase 2, which has now become a public-private partnership, already had secure funding and federal approval as a traditional procurement project.
- ***This project will cost more as a public-private partnership than it would have under traditional procurement processes.*** Under the original funding plan, construction costs were estimated to be $499 million, and Caltrans estimated that its operating and maintenance costs would total $128 million over 30 years. Thus, the original plan's total cost during this period would have been $627 million. Under the current plan, the state will pay $173 million upon completion of construction and then $28 million per year for 30 years, for a total of more than $1 billion.
  In addition, the LAO notes that the current construction market is extremely beneficial to public projects, and that a traditional procurement process aimed at awarding bids to construction companies to rebuild Doyle Drive conducted this year would likely have had numerous bidders competing for the job at very low profit levels. Caltrans has reported that some recent construction bids have come in at 30 percent lower than estimated due to intense competition for work. The contract with Golden Links suggests the company could earn a profit of about 20 percent.
- ***Project completion has been delayed due to the shift to a public-private partnership.*** Under the original 2009 plan, construction on Phase 2 of the project would have begun around October 2010 and ended by June 2013. Under the current plan, Caltrans now estimates that construction will be complete by December 2014.
- ***The state has retained some risks that may negate one of the key advantages of a public-private partnership.*** The LAO has raised concerns that Caltrans' contract with Golden Links does not transfer as much risk to the private entity as Caltrans has contended. The LAO notes that the state will bear cost increases due to the discovery of hazardous materials, endangered species or archaeological or cultural artifacts. In many public-private partnerships, costs attributed to such discoveries are borne by the private entity, not the government.
- ***The funding strategy sets the Presidio Parkway as a top priority for the State Highway Account for the next three decades.*** A key concern of CTC staff is the availability payments, which commit State Highway Account funds to the Presidio Parkway Project for 30 years. Committing a statewide funding account to one project in one region for that long of a period has never been done before.

- ***The project is the subject of current litigation.*** The Professional Engineers of California Government have sued the state over the project, suggesting it is not an appropriate public-private partnership under the 2009 statute.

Caltrans argues the project makes financial sense and is an appropriate public-private partnership. In presentations and letters to legislative staff and the CTC, Caltrans has stated that the Presidio Parkway Project is a good candidate for a public-private partnership. Caltrans consultants have used the concept of net present value to state that the project is actually less costly done as a public-private partnership. Net present value is a common economic tool used to evaluate long-term projects, and is based on the theory that money is more valuable in the present term than in the future. Thus, projects that delay spending, such as public-private partnerships, can have more value even if they appear to cost more in the long term.

According to Caltrans calculations, delaying up-front construction costs and transferring some risk to the private entity presents the state with a better value for money over the long term than a traditional procurement process, which would require more up-front funding. Caltrans states that the public-private partnership costs would actually be 23 percent lower than traditional procurement costs based on their calculations, which assume that money in the future is 8.5 percent less valuable than current dollars. The LAO agrees that using a net present value economic analysis is appropriate, but argues that its net present value analysis still found that a traditional procurement process makes more financial sense than the public-private partnership costs for this project, particularly in the current construction market. The LAO believes that net present value analyses should be based on the assumption that future money is 5 percent less valuable than present-day dollars.

Caltrans also states that due to the complexities of this project, partnering with a private entity to share risk is good policy. Caltrans notes that project challenges include keeping the roadway open to traffic during all phases of construction and coordinating with four different federal agencies that have jurisdiction over portions of the project, and thus, the project is likely to include cost overruns that can be shared by the private entity.

Caltrans also notes that the private entity will be required to maintain the roadway at a high level after construction is complete or face lower annual payments. In addition, they state that the public-private partnership will allow as much as $175 million from the State Highway Account to be used in the near term for other projects, due to the delay in spending money on this project. Caltrans, however, has been unwilling to provide the LAO with a list of shovel-ready projects it will use that money on.

Attachments:
Caltrans, "Revised Project Proposal Report for the Presidio Parkway Public-Private Partnership Project." Chapter 3: Basis of Public Interest Finding. May 4, 2010.
Legislative Analyst's Office, Letter to Sen. Alan Lowenthal. December 9, 2010.
California Transportation Commission. "Staff Analysis of Project Description, Financial Plan and Approval Criteria." May 15, 2010.

*****Please see PDF : LAO Concerns, CALTRANS Presidio Parkway Proposal, and CTC Staff Report***

CONCERNS OVER ANALYSIS AND OVERSIGHT OF PUBLIC-PRIVATE PARTNERSHIPS

Based on the process surrounding the development of the public-private partnership for the Presidio Parkway Project, there are several policy and process concerns the Legislature could address before additional public-private partnerships are proposed. Among those concerns are:

- ***A lack of independent oversight of the specific financial and contract terms.*** SB x2 4 repealed the Legislature's ability to approve or reject specific proposals, instead giving the Legislature a 60-day review period in which it is allowed to make comments to the executive branch agency seeking the project but has no authority to green light or stop projects. While SB x2 4 does require Caltrans to submit projects to the California Transportation Commission (CTC) for approval, CTC in this case noted that Caltrans refused to provide the Request-for-Proposal documents before CTC was asked to approve the Presidio Parkway Project. There are concerns that the previous law requiring legislative approval stymied the development of public-private contracts by adding too much uncertainty. The Legislature may wish to refine oversight processes, however, to give itself, the CTC or another agency more ability to meaningfully review projects. In this case, the outgoing Schwarzenegger administration committed the state to a project that will cost more than $1 billion without any public hearing that focused on the specifics of the proposed contract.
- ***The Legislative Analyst's Office (LAO) and Caltrans disagree on a base assumption needed to perform economic analysis on the costs and benefits of this project.*** While both Caltrans and the LAO agree that economic analysis utilizing the concept of net present value is one appropriate way of measuring a project's benefits, they differ greatly on the rate at which future money should be discounted. The Legislature could consider requiring the LAO and agencies proposing public-private partnerships to agree on these assumptions before the legislative review period, so that the Legislature and the public can focus on other issues when considering the benefits of a specific project.
- ***Should public-private partnerships be restricted to projects that generate new revenue?*** Public-private partnerships in the transportation sector have typically been used to create a project that generates new revenue, thus requiring the users of the project, not taxpayers or other government funds, to pay for the project. A key question raised during the CTC review of this project was whether it was appropriate to make a decades-long commitment of statewide funds to one regional project, and whether this project would lead to other similar projects in other regions. The Legislature may wish to consider clarifying whether it believes projects that do not generate new revenue should be eligible for public-private partnerships.