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The Need for Expanded Use of Public-Private Partnerships in California Infrastructure Procurement

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California rightly thinks of itself as being a global leader in innovation, and a place where important trends begin. While this is clearly true in many fields, in the case of infrastructure finance and development it is not. In fact, California is far behind the global curve, as for more than two decades other countries and provinces have developed successful models for engaging private sector finance and management expertise to fund and operate selected public infrastructure. If California was flush with cash and had all the resources required to build and maintain the infrastructure it needs to be competitive, this might not be a problem. But California clearly does not have those resources in its public budgets, and even if it did, the state still needs to consider how to finance, build and operate its infrastructure with maximum efficiency, and maximize its return on investment of taxpayer dollars.

Let me be clear at the outset what the term “public-private partnerships” means. It is not privatization. While there are many variations, the underlying concept is that the government sets the performance requirements for a facility it needs, and for the services associated with it; a private party (usually a consortium) contracts to provide the finance, build, and operate the asset for a fixed period – usually 30 years – after which the asset reverts to the government. If the asset is not delivered or maintained to specification, the agreement can be terminated. Transportation (roads and bridges) usually comes to mind when people think of public-private partnership projects (P3), but the same methods can be used just as effectively to develop social infrastructure such as university facilities, schools, hospitals and water projects.

The Bay Area Council Economic Institute has been analyzing P3 strategies since 2006, through a series of analyses: *Investing in California’s Infrastructure: How to Ensure Value for Money and Protect California’s Competitive Position in the National and Global Economy* (2006), *Public-Private Partnerships: Alternative Procurement Methods for Campus Development in the University of California System* (2010), *Framework Conditions for Foreign and Domestic Private Investment in California: Seizing the P3 Opportunity* (2010), and *Accelerating Job Creation in California Through Infrastructure Investment* (January 2012). All four reports can be accessed on the Institute’s website www.bayareaeconomy.org.

The first study analyzed global best practices in this field, and the opportunity present for the state. The second, produced at the request of the Business Transportation and Housing Agency, addressed the question – following passage – what could make the state more competitive as a site for global infrastructure investment. The third presented a model for how the University of California could make effective use of P3 methods to build facilities throughout the state, including its Merced campus. The most recent analysis,

Accelerating Job Creation in California Through Infrastructure Investment (January 2012), which provides updated information on P3 experience in other countries, and links accelerated infrastructure development to California jobs, has been provided to the Commission with this statement.

From our work on this issue, I would point to several high-level conclusions:

1. Other jurisdictions – most notably the United Kingdom, Australia, and Canadian provinces such as Ontario and British Columbia - have led the way in developing public-private partnerships as a tool for infrastructure development. Since 2000, \$70 billion in private capital has been deployed in 620 projects in the UK. Infrastructure Partnerships of Australia forecasts that 15% of the country's estimated \$400 billion in infrastructure investment over the next ten years will come through P3s. Canada has 62 projects in the pipeline or under development. Brazil plans to activate \$21 billion for 16 projects through its Project Structuring Division and the Brazilian Development Bank.

In the process, the more established programs have developed successful models and a deep reservoir of experience regarding what works and what doesn't. In the US, states like Virginia are ahead of us, and Chicago Mayor Rahm Emmanuel recently announced creation of an Infrastructure Trust. California doesn't have to replicate their models, but can certainly learn from them.

2. P3 methods aren't a silver bullet for solving the state's infrastructure needs. Global experience shows that roughly 30% of projects may be appropriate for P3 development; the rest are best developed using traditional government procurement methods. But 30% can take a sizeable dent in California's infrastructure deficit, which has been estimated by the Nicholas Berggruen Institute at \$765 billion over the next ten years. Thirty percent of that figure is \$230 billion – which is the scale of private investment the state could potentially attract.
3. What would the state gain from using this infrastructure finance method more extensively, besides the investment dollars?
 - P3 projects typically save 15-30% of the cost of conventional government procurement. Global experience shows that P3 projects are delivered faster, with few (if any) over-runs. This accelerated delivery accounts for a large part of the savings.
 - Funds the government saves can be allocated to other priorities.
 - P3 projects include maintenance by the private sector partner over the life of the asset, which is usually 30 years. When government budgets are tight, maintenance is often cut or deferred. With P3s the private party must operate and maintain the asset up to an agreed standard, or lose the contract. In the end, the asset is conveyed to the state in good repair.
 - Due in part to this superior maintenance, P3 projects tend to deliver better service and achieve higher levels of customer (user) satisfaction;

- Properly designed, P3 contracts can offer an opportunity to engage private sector expertise to deliver new and innovative solutions to design and service challenges.
- The Economic Institute calculates that \$250 billion in infrastructure investment in the state would directly produce 1.7 million jobs over ten years, and 3.4 million total jobs when indirect and induced jobs are counted – taking a sizeable bite out of the state’s unemployment, particularly in construction. Investment of \$500 billion or \$50 billion would of course produce more jobs.

While each would require due diligence, a wide range of specific projects around the state - such as high-occupancy toll lanes in the Bay Area, California High Speed Rail, BART rehabilitation and expansion, LA Measure R programs, and the East Otay Mesa Port of Entry in San Diego could potentially benefit.

If this is the scale of the opportunity, where do we stand today?

SB4, passed in February 2009, removed the prior cap (of 4) on development-lease agreements undertaken by The Department of Transportation and regional transportation agencies, extending the authorization for such agreements through 2017. The first, and only significant, project under that bill is the rebuilding of the Presidio Parkway (Doyle Drive) from the Golden Gate Bridge into San Francisco. It saved Californians \$267 million, reducing costs from an estimated \$625 million to \$358 million (net present value.) Outside transportation, the most significant project is the Long Beach Courthouse. In the University of California system, P3 methods have been used to develop a number of stand-alone facilities, including the West Village at UC Davis, and the new Neuroscience Building at UCSF. While welcome, this is less than an impressive pipeline, given the scale of the state’s infrastructure needs, and the fact that no new projects have been advanced since 2010.

SB4 also created the Public Infrastructure Advisory Committee (PIAC) to advise the California Transportation Commission, the Governor and the Legislation on P3 projects. Paralleling the lack of new project activity, and a general lack of policy direction from the executive branch, the PIAC has not been convened since 2010.

To be an attractive market for large-scale infrastructure investment from the private sector, California needs a robust project pipeline and an established set of procedures that provide efficiency, predictability and transparency to the procurement process. While the procurement mechanism used for the Presidio Parkway worked, at the moment California lacks both a pipeline and a fully institutionalized procurement process.

What needs to be done?

P3 investment should firmly be placed on the state’s policy agenda as tool for infrastructure development.

The PIAC should be activated.

Following global best practice, an infrastructure procurement “center of expertise” should be established to develop a project selection process (similar to the “comparator” used in the UK), establish performance metrics, support public sector negotiators, and facilitate transactions. This center could potentially be located in the Infrastructure Bank, if it were supported with the necessary resources and staffed with professionals who are expert in the field. Alternatively, and better perhaps, the center could be established as a free-standing 501(C)3 or Limited Liability Company (LLC) that is empowered by the state (with state oversight), staffed by professionals, and supported by a mix of public and private resources.

It is difficult to see how California can accelerate its infrastructure development and compete for private investment without a visible commitment to this course, a commitment of resources, and a process (through a center of expertise inside or outside government) to advance the public interest, ensure transparency, and build a project pipeline that attracts investor interest.

Even though this is comparatively new territory for the state, it is not a novel idea. Other jurisdictions have done this for decades – we’re just behind the curve. The California Economic Summit (www.caeconomy.org), in its May 2012 deliberations made many of the same recommendations. And last year the President’s Council on Jobs and Competitiveness (www.jobs-council.com) advanced similar ideas at the national level. Other jurisdictions have now used public-private partnerships to support their infrastructure priorities for decades. Whether for budgetary reasons or to achieve better service, it is overdue that California become as innovative in its public infrastructure policies as it is in other fields.