



MODELS FOR TRANSPORTATION PROJECT DELIVERY

How to determine what works and what doesn't

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In the modern history of public-private partnerships in the United States, the prevailing project delivery models have been the toll concession and the availability payment contract. In both cases, a private party raises equity and debt financing and takes responsibility and risk for completing the design, as well as constructing and providing long-term operations and maintenance. The major difference between the two is that in the toll concession, the private party takes the revenue risk and secures its debt only with project toll revenues, while under an availability payment contract, the public project sponsor takes the revenue risk by agreeing to make payments to the private party based on project milestones or performance standards. These payments become the security for the private party's debt and return on investment.

Second Thoughts

There are signs, however, that we are witnessing some second thoughts by public owners about entering into long-term toll concessions and availability payment public-private partnerships (P3s). The response to this scrutiny is taking the form of what seems to be the next trend in domestic P3s — design-build-maintain (DBM) and design-build-operate-maintain (DBOM) project delivery. This type of contracting came about before the toll concession model emerged, such as the DBOM contract for the Hudson-Bergen Line in New Jersey in the 1990s. But DBM and DBOM have remained a pretty quiet tool until recently. That has all changed with a slew of Texas Department of Transportation (TxDOT) projects

deploying DBM project delivery, and it is catching on in other jurisdictions as well. It started with TxDOT's State Highway 130, Segments 1-4. After a hiatus of several years, in quick succession TxDOT procured or is in the process of procuring DBM contracts for the I-35E, SH183, Grand Parkway Segments H, I1 & I2, Harbor Bridge Replacement Project in Corpus Christi, and SH360. The Arizona Department of Transportation (ADOT) has followed suit with its Loop 202 South Mountain Freeway project.

Maybe no project exemplifies this evolution more than the Knik Arm Crossing in Anchorage, Alaska. A single purpose agency, Knik Arm Bridge and Toll Authority (KABATA) first sought to deliver the project as a toll concession using tolls as the sole source of revenue. KABATA abandoned its toll concession procurement in favor of an availability payment P3 when it became clear that the short listed proposers would not proceed without state subsidies of the tolls due to the significant revenue risk in the early years. The availability payment procurement depended upon further legislation to establish a sound state source for payments subject to appropriations. While KABATA's detailed risk-adjusted cost estimates and financial analysis indicated that this was the state's most beneficial way to deliver and finance the project, the Alaska Department of Revenue had different ideas and prevailed with legislation and appropriations that paved the way for public financing. The Knik Arm Crossing is now likely to proceed, if at all, under a DBM delivery model, the third procurement for the project.

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Analyzing the Trend

So what explains this trend? In my opinion, three principal forces are at play. The first is value for money. The cost of funds with tax-exempt public financing is generally lower than the interest rate and rate of return on private sector borrowings and equity investment. This is an important distinction when financial analysts compare the anticipated whole life costs of the DBM delivery method to the whole life cost of a toll concession or availability payment delivery method. While the latter two have their own advantages in terms of private sector efficiencies driven by the transfer of risk to equity, this advantage does not always make up the difference in the higher financing costs versus tax exempt bonds, at least in the eyes of public sector chief financial officers. There is a growing view that marrying a long-term maintenance obligation with the design and construction obligation, all backed by performance bonds and parent guarantees, provides sufficient motivation for the private sector to focus on life cycle cost efficiency and project performance without the need for an equity investment. As a result, quantitative cost comparisons between design-build-finance-operate-maintain (DBFOM) P3s and DBOM/DBM P3s sometimes do not produce meaningful differences in risk-adjusted costs to design, construct, operate and maintain. Any narrow difference in favor of DBFOM is sometimes reversed when the cost of money is factored into the calculation.

The second force at play is a perception of greater public owner flexibility under the DBM method as compared to

availability payment P3s. Public owners are effectively locked into long-term payment obligations with availability payments that reflect the higher performance expectations of private parties than what a public owner would typically expect. The cost to exit early is enormous, because the termination compensation must be enough to retire the private party's outstanding debt and breakage costs, and provide a rate of return on the equity investment. DBM termination compensation is insignificant by comparison. At a time when public owners are seeing stagnant or declining revenues to pay for highway operations and maintenance at both the federal and state levels, they are reluctant to take on long-term payment obligations that can only be cancelled at the price of paying off debt and equity early.

The third factor is apparent private sector acceptance of DBM procurements. TxDOT first put its toe in the water with optional maintenance terms of five years each up to a total of 15 years. Subsequently, TxDOT has moved to mandatory maintenance terms as long as 25 years, with termination for convenience rights. ADOT may push the envelope to 30 years for the South Mountain Freeway DBM contract, as indicated in its RFQ for the project. ADOT has received five statements of qualifications.

All three factors drove ADOT's decision to pursue DBM project delivery for South Mountain. The quantitative part of its value for money analysis slightly favored DBM over a DBFM availability payment alternative. On a qualitative basis, ADOT could not justify the level of year-in, year-out expenditures that the DBFM model

would bind it to on a project that is a lower maintenance priority than the I-10 and other major freeways in the Phoenix area. Finally, two states away, TxDOT was getting excellent competition and bid results for its DBM projects.

Opening the Debate

In noting this trend and its possible reasons, I am not implying that DBM is a better project delivery tool than toll concessions and availability payment P3s. The comparative advantages and disadvantages of each are certainly open to debate and will vary by project. But it is equally certain that those who believe strongly in the benefits to government from private financing and equity participation will have to sharpen their analytical and persuasive skills if they want to forestall this emerging trend. And only time will tell whether the value to be realized from the incentives created by the toll concession and availability payment P3s to deliver projects on time and with a high level of performance will be realized in a way that makes these tools more attractive than the DBM approach. ♦

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