MINUTES
Legislative Study Commission on Public-Private Partnerships
December 15, 2010, at 9:30 a.m.
Room 1027, Legislative Building
Co-Chairman Clark Jenkins, presiding

Chairman Clark Jenkins called to order the second meeting of the Joint Legislative Commission on Public-Private Partnerships at 9:30 a.m. on Wednesday, December 15, 2010. The following members of the Commission were present: Representative Deborah Ross, Co-Chair; Senator Margaret Dickson; Senator Bob Rucho; Representative Bill McGee; Representative Joe Tolson; Ms. Angela Carmon; Mr. James N. Copeland; Mr. William J. Klein; Ms. Mary Nash Rusher; Ms. Gloria Shealey; and Mr. Richard E. Vick. A copy of the agenda and a roster of visitors to the meeting are available in the 12-15-2010 folder at the Commission's website: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Chairman Jenkins asked for a motion to approve the minutes from the meeting of November 30, 2010; and Representative McGee so moved. The minutes were unanimously approved. A copy of the minutes is available in the 11-30-2010 folder at the Commission's website: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Chairman Jenkins introduced the first speaker, Mr. Steve Cohen, an Assistant Director in the Physical Infrastructure Team at GAO. Mr. Cohen oversees studies that evaluate financing and performance of federal surface transportation programs, particularly highway and transit programs. He is a graduate of American University and has worked for GAO for 30 years. A copy of Mr. Cohen's PowerPoint presentation is available at the Commission's website in the 12-15-2010 folder: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Mr. Cohen said GAO is an independent agency of the legislative branch of the federal government, commonly referred to as the "congressional watchdog" or "investigative arm of Congress." He said they conduct audits and investigations and make recommendations to federal agencies and to the Congress, when appropriate, to improve the performance and accountability of federal programs.

Mr. Cohen said he focused on the highway side of things, and he said he would start out with public-private partnerships (PPPs) from a transportation perspective. He said the Department of Transportation defines PPPs fairly broadly in referring to them as contractual agreements allowing for greater private sector participation than would be traditional. He said that definition encompassed a wide variety of arrangements ranging from creative contracting to more complex partnering with the private sector. So what is traditional? He pointed out an example of a traditional procurement model on page 4 of his presentation, which depicts how state departments of transportation do business across the country. He said when state DOTs actually construct highway facilities they contract with the private sector, and once the facility is up and running they operate and maintain the facility.

Mr. Cohen said the chart on page 5 of the presentation might be a more real-world version of traditional. Traditionally known as outsourcing, the private sector is involved pretty much along the whole continuum of activities required to design, build, operate and maintain our highway facilities. He said GAO's work has shown fairly dramatic growth in outsourcing over the last five to seven years as states have grappled with budget difficulties, the loss of key skill sets, and the need to do more with less. In the next chart (page 6) you see arrangements, which are in the transportation community, widely considered public-private partnerships. The private sector plays a more crosscutting function across the range of activities. For example, design-build in which a contractor or contractors both design and build the facility with asset management at the back end of the process and where the private sector is a lot more involved in helping to optimize the performance and cost effectiveness of our transportation facilities.

Mr. Cohen said the chart on page 7 shows a broader model where the crosscutting role has become a good deal more expansive. He said the key difference here is that the private sector is not involved in financing the project and may have a direct stake in the financial success of that project. But if you think of the so-called "Greenfield" and "Brownfield" models of the public-private partnerships, the top line represents the new Greenfield facility and the bottom line represents the scenario under which an existing facility might be leased to a private concessionaire.

Page 8 brings you to the work that GAO did. Mr. Cohen said they focused exclusively on highway public-private partnerships and particularly those deals where the public sector enters into a contract lease or concession agreement with private sector firm or firms to design, construct, operate, and/or maintain the facility usually in exchange for an up-front payment known as the concession payment, usually for an extended period of time, and where the private partner receives toll revenues over the length of the agreement.

Mr. Cohen said there are numerous other forms of public-private partnerships in the transportation sector. He said the availability payment model came to mind where the concessionaire (private partner) may not be receiving toll revenues but would rather be receiving a payment based on the performance and availability of the facility. He said they didn't look at that model or other models, so what he has to say applies to the first example.

Mr. Cohen said they looked at public-private partnership projects in Texas and Oregon where new facility plans were just getting started. Texas at the time had just entered into its first concession agreement, the State Route 130 project, which was the extension of the Texas Turnpike. He said they looked at the Chicago Skyway and the Indiana Toll Roads Project, both of which were existing facilities that were leased to the private sector for a period of 99 and 75 years, respectively. He said GAO visited the Toronto facility, which was a hybrid, publicly built and then almost immediately turned over under a lease arrangement to the private sector. He said they also conducted work overseas to get a better understanding of the model there, and they visited Spain, Australia, British Columbia, and the UK. In doing this work they reviewed development concession agreements that were in place as well as federal and state guidance, and they interviewed a fairly wide range of players about what they were doing, why they were doing it, and the challenges that they were facing. Their key questions focused in three areas: advantages, benefits, costs and tradeoffs; how public officials have acted to protect the public interest; and the federal role. He said at the request of the Commission's staff, he expanded on the federal role question a little bit to talk about some of the emerging issues in the reauthorization environment that might at this point be affecting public-private partnerships.

Mr. Cohen started with the first question, what are the advantages, benefits, costs and trade-offs? (See page 12 of the presentation.) He said he would try to cover them one at a time. The first advantage is financing the construction of new facilities while minimizing the use of public funding. This advantage basically allows public agencies to conserve funding from highway capital improvement programs for other projects at the same time accelerating the pace of private development. In the toll scenario, it allows public agencies to avoid the up-front cost of borrowing needed to bridge the gap until toll collections become sufficient to pay the cost of building the road and the cost of paying interest on borrowed funds; and finally, it allows states and localities to avoid legislative or administrative limits that govern the amount of outstanding debt that states are allowed to have. He said this lateral limitation is not unique to the United States. In fact, Spain and other European countries have embraced PPPs as a way of keeping debt off their public books and, therefore, meeting European Union standards. Nor are these advantages unique to constructing new facilities. In Indiana, the state received a $3.8 billion concession payment, which it then used to fund a ten-year statewide transportation plan.

Secondly, Mr. Cohen said there are advantages attendant to transferring and sharing risks with the private sector. This translates into potentially more reliable and accurate estimates of cost revenues and risks. The theory here is that the private sector has a financial stake in the success of the project; therefore, you are more likely to get a scenario where you are getting a more reliable analysis of cost, revenues, and risks than public agencies would do in the same circumstance that don't have that same incentive. Mr. Cohen said what that translates into is more accurate estimates of construction costs and schedules and, therefore, the potential of completing projects on time and on budget as well as more accurate estimates of levels of traffic and revenue, which would translate into a more financially successful toll project where toll revenues are supporting the operation and the future expansion needs of that facility.

Finally, the advantages of improved life-cycle management investment decision making (page 15). Mr. Cohen said this is primarily more predictable funding for capital for maintenance and capital repairs, and the reason for that is publicly-funded project maintenance and upkeep is subject to annual appropriation cycles. In a public-private partnership, the concessionaire generally would be held by contractual provisions to maintaining the facility up to a specific performance standard, usually as good or better than the public would have done in the same situation. This can potentially result in lower life-cycle costs and can potentially result in more rational investment decisions because a private partner will look to see a business case or economic justification before investing in expansion or other sorts of improvements. That said, Mr. Cohen said you can do the incept concession agreement putting in expansion triggers and other sorts of things that will compel the private sector to do certain improvements under certain scenarios.

Moving on to the costs and trade-offs, Mr. Cohen said there are three things he wanted to cover separately (page 16). First and most importantly, he said there is no free money. A public-private partnership can be a valuable tool for financing and leveraging, but it is not new money.

It is borrowed funds that ultimately have to be repaid by the public in the form of increased tolls over an extended period of time. He said it is very important to understand that. There will be higher tolls on a privately-operated toll way than there will be on a public toll way, and that's simple reasoning. The private sector is seeking a return on its investment by collecting toll revenue. To get that return and to deliver the benefits, which he just outlined, this is a business model that relies on regular, frequent, sustained, often automatic, sometimes aggressive toll increases beyond what public agencies appear, to date, to have been willing to power. And that is a trade-off that has to be understood upfront.

Higher procurement and financing costs (page 17). On the projects that GAO has looked at, Mr. Cohen said the public has invariably had the need to bring in financial and legal advisors to pursue public-private partnerships, and they don't come cheap. On the financing side, he said it is always less expensive for the public to borrow money than for the private sector.

Mr. Cohen said the second area of trade-off is the potential loss of public control (page 18.) In setting toll rates, he said he had not seen any example where the public played any type of meaningful role in the setting of toll rates. Again, that is something they can be negotiated as part of the agreement, but there are practical and political implications to the public for giving that up, and that has to be weighed.

There is also the risk of the private partner being in an overly favorable market condition if it becomes a monopoly situation either owing to the lack of travel appointments to the public or because of the concessions going over a long period of time. Things happen over a long period of time. You can put a facility in place, commercial and residential development grows up around that, and ten to fifteen years later you essentially have a captive market. Mr. Cohen said all of that has to be thought through as well.

Finally, Mr. Cohen said the notion of short-term versus long-term benefits is a little more complicated. He said because upfront payments have been used in the examples looked at, at times for funding immediate need, it raises the question about whether these arrangements provide long-term benefits to future generations who will potentially be paying progressively higher toll rates throughout the life of the agreement to support current beneficiaries. That came up in Chicago, which used some of its proceeds for short-term, and it came up in Toronto where it had used all of its proceeds for short-term benefits.

Mr. Cohen said the other issue is the stream of revenues that the public sector is giving up over an extended period of time and whether, in fact, the value of those toll revenues over time is larger than the value of the concession agreement that you're getting up front. It could be. Mr. Cohen said it could go the other way, too. He said this conversation has come up not ten, twenty, thirty years later but in two, five, and seven years later both in Toronto and Indiana because they were concerned about the value they got for the facility that didn't turn out to be worth the stream of revenues. He said the lesson from that is getting upfront valuation right. He said GAO hasn't tried to take sides on this argument; but in looking at the arguments made, it is very clear that you can take a very, very small adjustment in an assumption and it can wildly change the answer. So this is something that has to be approached very, very carefully, he said.

Mr. Cohen moved on to how public officials acted to protect the public interest (page 20). He said this has been done mainly through the terms of the concession agreements that are entered into with the private sector. Asset performance measures, such as operating and maintenance standards in the agreements, which GAO has looked at, have specified very solid performance standards, specifying the level of pavement smoothness, safety features, and snow and ice removal. In Indiana they tell the private partner how quickly it has to remove road kill from the road. And, there are expansion triggers such as monitoring levels of service on these roadways and how congestion is occurring over time; and these agreements provide that if congestion reaches a certain level, then the private partner has to take measures to alleviate that including potentially adding lanes, if that's what it takes, or the concessionaire faces private penalties.

Mr. Cohen said there have been toll rate limitations placed in some of the agreements, but the GAO economists are not persuaded that these are really going to constrain the concessionaires to a tremendous extent, nor is it realistic that a private partner is going to agree to something over an extended period of time that's going to be an undue constraint on their ability to manage tolls.

Mr. Cohen said revenue sharing is something that came up recently in Texas. That means if the concessionaire's rate of return exceeds a certain level, and toll revenues are higher than were anticipated at the time the agreement was signed, then the public can share in some of those excess revenues.

Finally there is accountability and flexibility. Mr. Cohen said additional oversight and monitoring has been put into some of the agreements and more flexible non-compete provisions as well.

GAO found that in other countries governments have been all for systematic approaches to evaluate the public interest before these agreements have been entered into, and these range from qualitative sorts of public interest tests to quantitative tests. Australia, for example, will rate how the public interest is affected in a perspective arrangement, by whether the views and rights of affected communities have been considered, whether safety is enhanced, and whether the process is sufficiently transparent. Or, they will do value for money analyses, which are used to evaluate whether entering a particular arrangement with a public-private partnership is most cost effective or is a greater public benefit than if the public had built or maintained the facility itself. To do this, these analyses look across life cycle costs including initial construction, operations and maintenance, and capital improvements. In the United Kingdom, they take a look at the risks that are transferred and put a dollar value on that as a way of trying to make that assessment. The use of those tools have been more limited in the U.S. to date. Neither Chicago nor Indiana gave any serious consideration to maintaining control over the facilities that were put under lease. In contrast, Harris County did a fairly extensive value for money-type analysis of its toll road system comparing whether it made sense to go with a concessionaire in a public-private partnership as opposed to retaining that for public control, and the results of that analysis resulted in Harris County retaining control of those facilities.

Finally, Mr. Cohen said he would talk about the federal role in all this. He said GAO found that direct federal involvement has been limited to date, generally determined by whether or not federal funds have been or will be used in a project. That said, US DOT under both the Bush and the Obama administrations have actively encouraged and promoted public-private partnerships. One important way they have done so is through some of the administrative flexibilities that they have available to them that essentially allows them to waive certain federal regulations that allow public agencies to bring the private partner in earlier in the process than would be normally allowed under federal procurement rules. Mr. Cohen said that flexibility was absolutely pivotal to Texas and Oregon going forward and doing their projects while at the same time maintaining their eligibility for federal funds. DOT has also developed model legislation for states to consider going forward. They have developed a pretty extensive public-private partnership website, and recently established an office of innovate program delivery pulling together some disparate elements in the department, in particular a tolling and pricing team, which is available to assist states and localities looking to go forward on this.

Mr. Cohen said GAO has a found a clear definition of national public interests in public-private partnerships has not been identified to date, and some of the arrangements they have looked at do raise those questions. Chicago and Indiana were both built with state funds but were, nevertheless, incorporated into the Interstate System. Sixty percent of the traffic on the Indiana Toll Road was interstate in nature, and the implications of interstate commerce was one issue they raised that was not part of the mix. Basically, that comes down to GAO's observations that US DOT has done a good deal to promote the benefits, but GAO thinks they could be doing more to assist folks like this Commission grappling with some of the potential costs and trade-offs and how to manage that.

Mr. Cohen said a long-term reauthorization for surface transportation programs remains to be authorized. It expired at the end of 2009, and it's been kept alive by short-term extensions. Part of what Congress did was set up a National Surface Transportation Policy and Revenue Study Commission to chart the future direction of surface transportation. They weighed in on public-private partnerships and suggested where these are entered into on the Interstate Highway System, a number of limitations, requirements, and recommendations they had like using the public sector comparator, capping the rate of toll increases, and limits on how proceeds are used. For that, they were very interested in ensuring that concession payments and other proceeds to the public from these arrangements not be used for non-transportation purposes or to subsidize transportation improvements in other parts of the state or metropolitan area, which both Indiana and Chicago would have run afoul of on both of those counts. And, finally, they were endorsing the notion of revue sharing.

The House Transportation and Infrastructure Committee also weighed in on a bi-partisan blueprint put out in the middle of last year. Mr. Cohen said they looked at it a little more expansively than just an Interstate. They were looking at restrictions in terms of the entire federal aid system. They would prohibit the non-compete provisions, seek to have toll impacts on interstate commerce analyzed before these deals were completed, and would assess potential traffic diversion and the potential for a mitigating impact on low-income travellers. They would also establish within DOT's federal highway administration an office of public benefit to oversee state toll plans and public-private partnership agreements on the Interstate System.

That brought Mr. Cohen to GAO's conclusions that highway public-private partnerships do show promise as a viable alternative where appropriate to meet demands, but it is not a panacea; and costs and risks must be evaluated upfront. He said getting to the benefits can only happen by weighing the costs and trade-offs through careful, comprehensive analysis. To that end, GAO has a recommendation for the Congress. He said it was not often that they made recommendations to the Congress, and they do so with all respect when they do. The GAO recommended that Congress direct US DOT to establish an objective criteria for what the national interests are in highway public-private partnerships and to think about whatever legal authority, assessment tools, and guidance they could put in place that would help the states that are struggling and grappling with this issue right now.

Mr. Cohen said that ended his presentation, and he would be happy to answer questions.

Representative Ross said it would be great if the Commission could get written examples of the qualitative and quantitative public interest tests even if they are not indigenous to the United States because this commission in January is going to try to come with a list of best practices or principles for any public-private partnership legislative that they have. Getting those written qualitative and quantitative assessments before those January meetings might allow the Commission to incorporate them into some of the recommendations they might make. Mr. Cohen said he would be happy to work with the staff to that end. He said there was particularly extensive body of work and analyses in the UK and British Columbia that would be helpful.

Senator Rucho asked if there were any pitfalls in determining value in Texas or Oregon. He also asked if there were any problems with the private sector collecting their money or having problems with default working under the rules and regulations set up in the agreement. Mr. Cohen said he was not aware of any defaults in any of the arrangements that they looked at. As to the question of the upfront evaluation and how to pursue that, particularly in British Columbia there are a number of tests and analyses that they did. He said he would also look to Harris County, which is probably the most real-world example in the United States of somebody that really undertook this in a careful way.

There being no further questions of Mr. Cohen, Chairman Jenkins introduced the second half of the GAO team, Ms. Sherry L. McDonald, Assistant Director of Natural Resources and Environment in the U.S. Government Accountability Office. She has been with GAO for 27 years and is involved in the natural resources and environment, eco system restoration, and water issues. Ms. McDonald has a North Carolina connection in that she has a daughter at NC State University.

Ms. McDonald said she would talk about wastewater and privately financed public-private partnerships in that particular area. View her PowerPoint presentation in the 12-15-2010 folder at: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121. As background for how GAO got involved, many of the municipal wastewater systems in this country were constructed about 50 years ago and are nearing the end of their useful life. Many systems now lack the capacity to handle the increasing volumes of wastewater that happen during wet events, and either rain or snowfalls can overwhelm systems. It is estimated that 850 billion gallons of untreated wastewater are released into US surface waters annually. While local, state and federal agencies and communities spend billions of dollars each year on the wastewater infrastructure, each day it is estimated that there is between $150 to $400 billion gap between what is being spent and what is actually needed for wastewater infrastructure. The House infrastructure committee she works with is concerned that unless additional investment is found, the gains made under the Clean Water Act over the past years will be at risk. Therefore, they have proposed a variety of approaches to help bridge that gap. These approaches include increasing funding to traditional wastewater funding approaches such as the Clean Water State Revolving Fund, establishing a Clean Water Trust Fund, establishing a National Infrastructure Bank, and using privately financed public-private partnerships in the wastewater sector.

Ms. McDonald said over the past several years the GAO has been asked to look at some of the proposed approaches. In 2009 they issued a report that looked at issues that needed to be considered in establishing a Clean Water Trust Fund. Earlier this year, the GAO issued a report on issues related to a National Infrastructure Bank and the extent to which privately financed wastewater PPPs were being used and what were some of the advantages and challenges to that. She said they particularly focused on private financing because they were looking at ways they could help bridge the gap between what is being spent now and what is actually needed.

For the purposes of the GAO report, Ms. McDonald said they had a very specific definition of the type of PPP that they were looking at. A privately-financed PPP for their purposes is a contractual agreement in which the private partner invests funds in wastewater infrastructure but it does not include full privatization where the private partner actually buys the facility from municipality. Their examination did not evaluate the effect of the agreements on communities' sewer rates and cost or level of service. That is primarily because most of the PPPs they found occurred more than 10 years ago and reliable data on these particular issues simply was not available for GAO to evaluate that particular impact.

To determine the extent to which wastewater PPPs have been entered into in this country, Ms. McDonald said they had to do a literature search. There is no data base or listing of these particular partnerships. She said they also contacted six major water companies in the United States that actually deal with water and wastewater PPPs to get additional information on who they were actually dealing with to make sure that they had as complete a list as possible. She said it was possible they missed some, but they think they had a fairly comprehensive list of PPPs in the country.

To determine the potential advantages and challenges of privately financed wastewater PPPs, Mr. McDonald said they actually contacted the officials of each of the municipalities that had entered into these agreements as well as the water companies that were involved in the area. She said they also conducted a study in four states: Alaska, California, New Jersey, and Ohio. In addition to contacting the communities that were involved in the PPPs, they talked to other communities in the area to find out if they had considered a similar agreement or why they had chosen not to go in that direction. They wanted to get a sense of what their financing options were; and they thought going to those in the same state, because state laws do vary, would give them a better sense of what was actually going on and what some of the advantages and challenges were in the particular area.

In doing their work, Ms. McDonald said they found there were two types of privately funded wastewater PPPs. The first was the design-build-finance-operate, and that was where the company is involved in almost every facet of that particular effort. The company is responsible for designing, constructing, financing, operating, and maintaining the facility. The municipality makes payments covering the debt service and operation back to the private company. The second is the long-term lease, or as Mr. Cohen referred to it, a concession fee model where they get an upfront payment from the private company and then have a long-term agreement for operations and maintenance of that particular facility. A municipality or the rate payers actually make payments back to the private company.

GAO found that privately-financed wastewater PPPs are uncommon in this country. They only found seven where municipalities had entered into agreements since 1992, which is when President Bush signed an executive order encouraging the use of public-private partnerships. They also found that although seven entered into agreements, all the agreements varied in their terms and also in their reasons for entering the agreements. For example, some of the communities had access to non-traditional financing while others were interested in up-front payments. Still others, because of regulatory deadlines they were facing, were looking for fast delivery and construction of facilities.

Of the seven PPPs, two were in California, two in Rhode Island, one in New Jersey, one in Ohio, and one in Alaska. As seen on page 8 of her presentation, the terms of contracts differ, the types of contract differ, and the assets also differ. One thing that was consistent with the exception of one PPP was the upfront payment, so that was clearly one of the advantages that they were looking for.

Ms. McDonald moved to the reported advantages of the privately-financed wastewater PPPs (page 9 of her presentation). She said one of the most common things that they heard was that entering into such a PPP would allow faster delivery of new facilities or facility upgrades. She said several of the municipalities were facing regulatory deadlines, and they were looking for ways to get new facilities or upgrades done very quickly. Both the municipality and the water company told GAO that private procurement is much more streamlined than what public procurement is, it’s not compartmentalized, and they don’t have to go by the same administrative regulations that municipalities have to go through. They thought this gave them a real advantage in terms of getting the facilities on line quicker.

The second advantage was access to alternative sources of wastewater infrastructure financing. In some cases municipalities were facing opposition from their communities and were not able to get bond approval in place, and others had low credit ratings so this was a way for them to get access to the funds that they needed to get their facilities in place.

The third advantage was cost and operations efficiencies. Because the companies can often spread their costs over several plants, they can buy supplies in bulk and may save on labor costs and electricity—efficiencies that a single plant operation may not be able to take advantage of.

The fourth advantage was greater access to expertise and technology solutions. The companies often have more experienced personnel and often have the funds to be able to be able to more clearly and more thoroughly research problems and come up with solutions.

The fifth advantage was upfront payments to municipalities. Ms. McDonald said being able to get that upfront payment was a huge advantage to many of the communities that GAO dealt with. Although six of the seven PPPs (featured on page 8) received upfront payments, at least three of them used the money for things other than wastewater infrastructure. One community used the upfront payment to supplement the general fund, another used it to stave off property tax increases, and one community proposed using the upfront payment to develop a scholarship fund so that every child in the community could attend a local university. She said it was very interesting to see that they were not necessarily re-investing the money in the wastewater infrastructure but were using it for other things.

The last advantage was increased focus on other municipal functions. Ms. McDonald said several communities felt that being able to give up the responsibility of a wastewater infrastructure allowed them to focus on other municipal responsibilities such as fire and police. They did have several communities that felt that wastewater was a core municipal function and wouldn't think about passing that function on to a private company.

Ms. McDonald said there were reported challenges to considering and developing privately-financed wastewater PPPs. First and foremost was public and private opposition to turning wastewater over to a private company. In many cases GAO was told that the public was very concerned about whether the level of service they currently received from a municipality would be the same if it were contracted out to a private entity, and they were concerned about rate increases and finding employment for the current public employees that performed that function.

Next were financing challenges. Ms. McDonald said private financing generally costs more than public financing. The investor is looking for a return, so it is often more expensive. Another challenge was combining private financing with public financing. You have to follow IRS rules very carefully or otherwise you might not be able to continue to issue tax-exempt municipal bonds.

Ms. McDonald said there was concern about loss of municipal control and what happens to rates over the long term.

Another concern was lack of experience with privately financed PPPs, and several communities that GAO talked to didn't want to be the first one on the block to try something new and risky. Many were reluctant to try it because there wasn't enough information on the pitfalls or how to go about doing it.

The next concern was costly and difficult contracting. Ms. McDonald said because most of the communities don't have experience with PPPs, the contract is key. They want to structure it so that long-term capital improvements and other aspects are considered so that the community is not at a disadvantage. She said most did not have the in-house expertise to consider a PPP. In fact, the National Resource Council 2002 Report found that the communities often had to go out and get outside expertise, which made the contracting go slower and made it much more costly.

Lastly, Ms. McDonald said there was difficulty entering into privately financed PPPs because of state and federal laws. She said some state laws outlaw the use of the same contractor to design and build a wastewater treatment facility. That was particularly true in Ohio. Another problem was that in order to enter into a privately-financed PPP, municipalities have to repay any remaining federal investments prior to accepting private financing. She said that would include the construction grants from the 70s and 80s that would have to be repaid as well as any grants that might have been made under the Recovery Act. EPA said that most of those grants have now been depreciated so that that is not really an issue, but it is something to think about when you enter into a PPP. She said they found one community that actually used its upfront payment to pay off a federal investment.

Ms. McDonald said one thing she wanted to leave the Commission with is that private financing is not free money. It is a form of private capital that must be repaid to investors seeking a return on their investment.

Co-Chairman Jenkins asked if there were any questions for Ms. McMcDonald.

Representative McGee said in North Carolina we have plenty of packaged plants that are owned by homeowners associations and other entities which connect into publicly-owned facilities, so you already have public-private industry providing wastewater management.

Ms. McDonald said there are some private wastewater facilities in the country. GAO focused on the municipal ones that were publicly owned. She said they didn't look at the private side of that. They were looking at municipalities that entered into an agreement with a private investor to either design, construct, build, or operate a facility. They were looking at what financing is available to help them bridge the gap existing right now between what people are currently putting in and what is actually going to be needed. She said they didn't looking at all aspects of public-private partnerships.

Representative McGee asked what is Veolia? Ms. McDonald said it is a private water company operating across the country but primarily in California.

Chairman Jenkins said he had a question. He said in looking at PPPs that build public transportation roads or whatever, if you have a problem with it, you can shut it down. If you wind up with a municipal sewage treatment plant that's got a problem such as causing a discharge into a private operation, does someone have the right to take the thing over and correct it?

Ms. McDonald said they did not look at that. She said that is why the contracts are so important because you have to have contract provisions to cover that, or you're going to fall back to the community later on. Ultimately, right now the way the contracts they looked at are structured, the municipality still is responsible for any violations because the way the laws are written, the communities can get a little more of a break if there is a violation. With private companies it is much more stringent. That is one of the reasons the municipality has maintained the control and ownership of the facilities, but they would have provisions written into the contract to cover such things as that.

Senator Rucho asked if the municipality wouldn't be doing the inspections, and Senator Jenkins said one would hope so. Ms. McDonald said that would be a key part of the contract.

Co-Chairman Jenkins said the next presenter would be Chris Lloyd, a Senior Vice-President with McGuire Woods Consulting out of Richmond. He is part of the Infrastructure and Economic Development team and has worked very closely with numerous public-private partnerships. He played a leading role in developing the passage of Virginia's public-private partnership laws. He served for five years with the Secretary of Commerce in Virginia under Governors Allen and Wilder. (See Mr. Lloyd's bio and presentation in the 12-15-2010 folder: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.)

Mr. Lloyd said he would start with defining a public-private partnership, talk on how Virginia got its public-private partnership law, discuss Senator Jenkins' proposed Senate Bill 822 two years ago, and end with lessons learned and challenges.

First Mr. Lloyd wanted to draw a significant difference between his presentation and the presentations given by the GAO staff, which focused on the financial side. One of the things he said he would make clear is that the Virginia model (and what was under consideration in North Carolina's SB 822) is not necessarily a financing tool. He said it is more of a procurement tool. He said there is a significant difference when you just look at a public-private partnership as a procurement tool.

Mr. Lloyd said he wanted to answer Senator Jenkins' question a little more clearly on what you see in some of the municipal transactions because the GAO facility was a privately-financed facility. He said what you do see, and it goes to Representative McGee's question, is a number of communities that go out and build those sewer treatment plants but turn it over to a private entity to operate and maintain it. He said he recently toured a facility in North Fulton, Georgia, one of the highest per capita income areas in Atlanta, where they have turned over their wastewater facility and their water treatment facility to Veolia to operate and maintain the facility. He said it was an incredible facility that treats 35 million gallons of wastewater a day that discharges into the Chattahoochee River, which is a national scenic river and part of the national park system. He said this sewage treatment plant looked like a college campus. It was all brick, and surrounded by $2 million homes. There was not a single odor, and there was no noise. Everything was state of the art. He said there is a county employee on site, who is the contract administrator who oversees everything. If there is a problem, there is staff who will come in within an hour and take over everything. If they violate any provisions of the permit or the contract, there are severe liquidating damages to the tune of $20,000, $30,000, or $50,000 a day. There are a number of protections built into the contract to make sure that there are not problems. They have been operating facilities for 15 years, and they are not only meeting but exceeding every performance criteria. They have never had a shutdown or a minor violation at their facilities. That is why you need to be sure that the contract is done right.

What is a Public-Private Partnership? Mr. Lloyd said in the structure as they have adopted it in Virginia, it is an alternative tool in the toolbox to develop infrastructure. He said there is no magic about Virginia's public-private partnership law. In fact, there is very little in the public-private partnership law that you probably couldn't do under either existing Virginia law or existing North Carolina law. He said there are a few places where it takes innovation to the next step, and he said he would go into those. But what is great about having a public-private partnership law is you get a predictable, repeatable, consistent process. The public knows what is going on, the private sector knows what is going on, and the governing bodies know what is going on. There is openness, accountability and transparency in the process; the contracts are available to the people so they can see them and know what is happening. This is in contrast to having a hodge-podge and having to create the model, which is what you would have to do under existing law. When you create a predictable, repeatable process it is a good thing for the public.

Mr. Lloyd said Virginia's public-private partnership statute is just a way to get to design and build. It creates a vehicle for bringing private funding to the table, but it is a way to get to design-build in the process in Virginia. He said Virginia went through a process back in the late 80s and 90s where whenever a locality wanted to do a project by design-build, they came to the legislature, and the legislature was being swamped with legislation because everybody wanted to design-build. Virginia has a very short session—45 days in odd years and 60 days in even years—and 3,500 pieces of legislation with a $40 billion budget, and they were being inundated with 50 to 100 pieces of legislation every year trying to deal with design and build. They couldn't handle it, so they turned it over to a panel to create the public-private partnership process, a law that is consistent, repeatable, and predictable to allow local governments to enjoy some of these powers with the General Assembly maintaining some oversight.

Mr. Lloyd said the law is not a panacea for resolving all procurement issues. In fact, he said the vast majority of all public transactions should be normal low-bid procurements. You don't do a roof replacement through a public-private partnership. You don't pave parking lots through public-private partnerships. You don't do small structured renovations through public-private partnerships. It's where you have those complex projects, which many of them are. It's when you are a community that doesn't build a new hospital every year. When you don't have the expertise in house; that's when you use a public-private partnership.

He said design-bid-build procurement is the way to go except when there is some rationale or reason to deviate from normal procurement. In fact, the Virginia law and Senator Jenkins' SB 822 created a process that specifically says to local governments, you should use the normal procurement process unless you make a finding in writing that says there is some advantage to be gained from going outside that process. And you have to demonstrate that there is some savings to the public sector, some new financing it brings to the table, something in the scope of the project, or some other public benefit that is delivered through the process. And you have to make that finding before you can even consider a public-private partnership. Mr. Lloyd said that was something the Virginia legislature insisted upon. He said a PPP is not a way to get something for nothing, and the GAO did an excellent job of saying at the end of the day someone's got to pay for this. And public-private partnership is not to be confused with privatization.

What are some of the benefits of public-private partnership delivery? Mr. Lloyd said the GAO presentations mentioned the benefits already, so he would not dwell on them. There is faster delivery, risk transfer, potential for cost savings, and greater private sector involvement in scope development. He said he wanted to focus on that one. He said what they have found in Virginia is that they thought it was going to be the large suburban communities that would use PPPs. Actually, that is not who has used it because they have large public works staff that are used to doing projects. In Northern Virginia near Washington, DC, they build two or three hospitals every year because they are growing so fast. They crank out fire stations like we add on to the deck of our house. A public-private partnership might offer them some benefit, but not a whole lot. It's the medium-sized communities that are actually seeing the most significant benefit. It's those communities of 50,000 to 100,000 people that don't build a hospital every year, that don't build a water and wastewater treatment facility, that don't build a public safety center but every forty years. They don't have a large public works staff, they don't have the expertise in-house to develop these projects, so they like having the private sector come to them with ideas and concepts from around the world with the best-in-class process for developing a project to fulfill a public need. He said it really is those medium-sized communities in Virginia that are the most significant beneficiaries of the public-private partnership process.

Why would you pass a public-private partnership statute? He said you could probably coble together anything that is in Senator Jenkins' bill or anything that is in Virginia's statute, with the exception of the unsolicited proposal process, under existing state law. But it is great to have a consistent, predictable and repeatable path that allows for these projects to be evaluated. He said a lot of people on the private sector side, but particularly local governments, like to have a public-private partnership statute because it shows that there's a legislative commitment to the process. They want to know what the rules of the game are before they move forward, and that's going to reduce costs and speed things up. And when they know that the legislature is committed to it, that's a good thing for a project. He said he would argue, particularly as they have constituted the law in Virginia, that they have greater accountability and transparency for these projects than under the normal design-bid-build. Procurements happen with design-bid-build, and the public never even knows about them unless there happens to be a newspaper article about it or they look at the legal notices section of the newspaper. He said very few people even read the newspaper anymore, much less look at the legal notices section to see procurements. Virginia's law, like the North Carolina proposal, requires that when proposals come in they are posted on the Internet immediately. There has to be a public hearing about every single project before the local government can take it under consideration. There has to be that written finding before you can do a public-private partnership. It even goes so far as to require that a copy of the contract, before it is executed, has to be made available to the public for them to comment on. He said that is an amazing amount of accountability and transparency in government projects, and that is something that the Virginia General Assembly wisely insisted upon. He said more states are following the Virginia model because they see that accountability and transparency in the process.

Mr. Lloyd said he would argue that having a public-private partnership statute increases developer interest. When they see that predictable, repeatable, consistent process out there, they get excited and want to pursue those projects because it's sexy on a company's resume to do public-private partnerships. He said it is the "in" thing now, and contractors and developers want to build their portfolios; so once they see the statute, that's a signal to them that this is the kind of state they want to do business in.

Mr. Lloyd said Virginia has a long history of public-private partnerships. They have different statutes in Virginia. They have the PPTA, which is the Public-Private Transportation Act that passed during the Allen administration in 1995, and it only deals with toll roads and design-build transportation projects in Virginia. He said they have fifteen years of history in developing major highway projects in Virginia. A number of toll roads as well as some design-build projects have a pavement warranty and a tax overlay district where you brought private financing in addition to bonds into a transaction.

In 2002, Virginia extended the PPP concept to other types of infrastructure with the passage of the PPEA, technically the Public-Private Education Facilities and Infrastructure Act. During the legislative session it became known as the Public-Private Everything Act the name stuck. Mr. Lloyd said probably 60-70 of Virginia's 135 jurisdictions have adopted PPEA guidelines. He said there is a statutory framework that the legislature approved, but then a local government or the State government has to adopt guidelines before it can entertain a public-private partnership.

Since 2002, Mr. Lloyd said Virginia has had about 100 projects completed or under review. They have seen projects smaller than a million dollars and all the way up to $2 billion. There are fire stations and jails. He said almost every jail built in Virginia now is done under a public-private partnership, and water and wastewater projects are going there very rapidly. With schools there is a mixed track record. Schools have not embraced public-private partnerships the way they thought they would, but there have been probably 20 or 30 schools built under PPP agreements. Courthouses are another project being built under PPPs, but with the economy the way it is, there is not a lot of local government construction going on right now. As he said earlier, the interest has been in medium-sized jurisdictions with infrequent or repeatable projects.

Mr. Lloyd said most people agree that the best parts of PPP agreements are the time savings that result from a project and the risk sharing. He said a normal, traditional procurement process in a local government can take from 18 to 36 months just to get everything in place before construction even begins on a project. The first PPP school that was done in Virginia near Fredericksburg went from a drawing on a napkin to students walking in the door in eight months. He said that was an incredible process because they had the designer and the contractor working together every step of the way. And that is part of the benefit of design-build. He said the project was also built for less than expected, faster than expected, and with no change orders because of guaranteed maximum price. If the contractor goofed up or there was something wrong with the design, the contractor ate it because it was a design-build. It was not what some people refer to as design-bid-build-litigate. He said a guaranteed maximum price with guaranteed schedules offers a number of benefits to the public sector. He again emphasized that a lot of the projects in Virginia, in fact almost all of them, have been publicly funded. The local governments and the state government have entertained private financing, but rarely have they embraced it. Essentially they have relied on the traditional financing tools to do the projects, but they have used the PPEA as the way to procure it to get to those efficiencies from the design-build projects.

What does the Virginia PPEA statute do? Mr. Lloyd said the statute defines terms and says what you can do. It talks about what has to be in a contract, and it talks about the accountability and transparency process. It essentially says, if you want to do a public-private partnership, you as a state agency or you as a local government have to adopt guidelines. And the guidelines talk about what needs to be in a proposal, how you score these projects, who is on the review panel, and how you go about the review and selection process. He said it talks about public involvement, and there is proposal preparation and specific requirements that you need for that jurisdiction.

What is the process under Virginia law for a public-private partnership? Mr. Lloyd said what it begins with is the public entity either soliciting a proposal or the innovation of an unsolicited approach, which is in the Virginia statute, which you probably cannot do under existing North Carolina or Virginia law outside the PPEA. The Virginia law creates a formal process for a private entity to come forward in an unsolicited way to a local government and say, "We looked at your capital improvement plan" or, "We have seen in the newspaper that you want this project," or, "We've been watching your board meetings and we see that you want a new school or a new fire station. Well, we've got what we think is a better mousetrap." And they come forward in an unsolicited way, looking at those guidelines. Mr. Lloyd said again that a proposal cannot be submitted to a local government until they have adopted guidelines.

The way the law works, if you receive an unsolicited proposal, it has to be made public for a period of not less than 45 days although most communities use 60 to 90 days and the state has 120 days for most of its projects. That proposal has to be out on the streets for any competitor or any member of the public to look at to see if they can come up with an even better way to develop that project. He said there are provisions under the Virginia Freedom of Information Act law that allows for certain very limited pieces of information in that proposal to be kept confidential. Usually it is not the bottom line cost but the components of the cost. If it shows exactly how the contractor came up with that cost, or if they have any intellectual property in those drawings or renderings of developing the project, that can be withheld from disclosure during that open competition period.

Mr. Lloyd said there is a two-stage process in the statute that creates a conceptual proposal, which is the initial document submitted, which is really just a rough idea of the team's qualifications, the proposed scope, the proposed cost, and some of the public benefits of that project. Again, this is a qualification-based selection; it is not based solely upon cost. That first document is just to see if you even qualify to develop this project.

Another innovation of the Virginia statute and in Sen. Jenkins proposal two years ago was the concept of a proposal review fee, particularly in the case of an unsolicited proposal. The idea being that for a solicited proposal, the local government has their team lined up and ready to go to review those proposals. But if it is an unsolicited proposal, it's going to come out of the blue to them. So when the private sector drops in that proposal, they drop in a check that is usually one-half of one percent of the private cost up to $50,000. That was something that the Virginia General Assembly insisted upon because they said they wanted to make sure that local government has their own accountants, their own attorneys, their own architects, their own engineers sitting by their side—not out of their own budget—to make sure they aren't negotiating for the public sector. He said an entire industry has developed in Virginia of these firms that have grown to advise the local governments. So it levels the playing field between the private sector and the public sector to make sure the taxpayers are getting the best deal.

Once a conceptual proposal has been submitted along with the fee, the local government then convenes a panel as set out in the law. Mr. Lloyd said the panel reviews all the proposals with their advisors at their elbows, and they shrink it down to three. Those three are then asked for a detailed proposal with scope, schedule, and costs locked in. He said it is a very fluid process with the scope of the project itself constantly evolving throughout the process. He said that causes discomfort for some people who are used to knowing exactly what they are going to buy from day one. He said the design of a parking garage in Fredericksburg was changed fifteen times before they signed the contract. In fact, they created an architectural review board and told private contractors they had to please that committee before they would sign the contracts. At the end of the day, the community got something that they are very proud of.

Mr. Lloyd said the detailed proposal then leads to either an interim agreement or a comprehensive agreement with one firm. The comprehensive agreement is the final contract that lays out all the rights and obligations of a normal contract. An interim agreement is a concept added to the Virginia statute a few years ago which eliminates some risks and contingencies from the budget by beginning design and testing before the final contract is signed.

As noted earlier, Mr. Lloyd said Virginia has significant requirements for public notification and a lot of hearings with the public involved every step of the way in public-private partnership.

How does Senator Jenkins' proposal in Senate Bill 822 differ from Virginia's PPEA? Mr. Lloyd said there are a few ways. One is that SB 822 does not contain the concept of an unsolicited proposal. Mr. Lloyd said he thought leaving the unsolicited proposals out of the legislation limits some of the opportunities for innovation and creativity. Second, there is no provision for a legislative review panel for state projects as adopted by Virginia a few years ago. He said Virginia does not have a State Construction Office, which oversees those projects or a Division of Insurance review like North Carolina has, so they have the legislative review panel.

Mr. Lloyd said Virginia maintains the current state laws on retainage, so there is nothing different there, and there is no change to the requirements for payment and performance bonds. He said there is a requirement in the North Carolina statute that is a little more explicit than the Virginia statute about requiring a governing body to set minority/business participation requirements. He said there is nothing in the North Carolina statute that could be argued to say that you are giving eminent domain power to a private entity. It does not create any new powers.

What are some of the issues that this Commission and the entire legislature should be thinking about in looking at a public-private partnership law? And how do you make it work for North Carolina? Although they share a border, Mr. Lloyd said Virginia is very different from North Carolina. Should minority contracting goals be mandated in the statute or guidelines? What is going to be the role of a State Construction Office or the Department of Insurance? Do you want to do unsolicited proposals? Should there be a stipend required for unsuccessful bidders? If you are requiring the private sector to evaluate concepts, should you at least provide them some compensation for their intellectual property? Mr. Lloyd said some people have asked if you should mandate “green” construction or just say it is desirable. He said some people have argued that you shouldn’t use a PPP for any project under $10 million or $25 million. He asked if minimum size should be added to the North Carolina statute. He questioned the role of the Local Government Commission in these projects. When a PPP statute bucks up against any other state restrictions on a qualifications-based selection, should the restrictions be removed in the drafting process?

What are some of the lessons learned? Mr. Lloyd said he would argue that an overly prescriptive solicitation fails. He said he’s seen solicitations 500 pages long that talk about exactly what color the doors need to be and which way they swing. He said that eliminates all the creativity and innovation on a project.

Mr. Lloyd said in Virginia they found that the in-state contractors were very concerned that there would be out-of-state contractors coming in and taking over when the PPEA passed. He said nothing could be further from the truth. Contractors out of California may have some world-class expertise, but they don’t have the contacts, relationships and reputations in North Carolina. He said they may bring a better mousetrap to the table, and they may bring some vehicles for innovative financing to the table, but they don’t have any of those relationships. So who do they call? Mr. Lloyd said they call the local government and ask what contractor and architect they like, and they put them on their team. So projects that may not happen but for the process, now start to happen with in-state contractors and with in-state architects because they are there to be the North Carolina face of the project. He said they often enter in venture partnerships with some of these firms.

Mr. Lloyd said you have to have some sort of governmental financial participation. Most of Virginia’s projects have been exclusively publicly financed, but that is starting to not be as much the case. He said every project needs an internal champion, but that’s more on the implementation side. He said where they have had problems with PPPs in Viginia is when one is rammed down somebody’s throat. There is either a legislator or a member of the school board that thinks that PPPs are the greatest thing since sliced bread, and they don’t bring anyone along with them. So the staff and the public fight them every step of the way. He said you need to have the consensus builders and champions who say that it is a good thing for the community and support the project along the way.

Mr. Lloyd said no company really dominates the field in Virginia; there is a fairly wide-spread group of companies of all sizes. There are contractors who do $30 million a year to contractors who do $4 billion a year.

Mr. Lloyd said it upsets his lawyer colleagues, but they are starting to standardize the contracts and agreements across communities. He said he maintains a website with every contract that has been done in Virginia on it, and that is reducing the amount of time needed to negotiate the deals.

What are some of the challenges the Commission might want to think about in enacting a public-private partnership law? Mr. Lloyd said there is a problem with the public-private partnership law now mainly for smaller water and wastewater projects or for school projects in rural communities. Right now USDA through the Rural Utility Service and Rural Development is making money available for those projects, and currently the PPEA is not an authorized procurement vehicle for tapping those funds. Mr. Lloyd said he met with USDA a few months ago in Washington, and once they realized that the public-private partnership was not privatization, they said, “Oh my goodness. Our mistake.” And they are working right now on a national bulletin to correct that because they see North Carolina is considering it, Georgia, is considering it, Texas will probably put it through this year, and Maryland has aspects of it. The USDA is starting to see this statute break out across the country, and they realize there was a mistake in their procurement vehicle.

Mr. Lloyd said you have to do everything you can to address the concerns of small contractors to make sure they don’t feel they are bulldozed on these projects, He urged the Commission to be sensitive to those concerns and address them appropriately.

He said North Carolina does have some baggage with earlier procurement reforms that are more unique to North Carolina. He said again that Virginia has a fifteen year history with public-private partnerships, and they are changing the statute every year to make it better, more innovative, and more transparent. He said North Carolina needs to overcome some of its baggage and learn from those mistakes.

Finally, Mr. Lloyd said he could not emphasize any more strongly that the public-private partnership process is not a financing statute. He said don’t listen to people who sell it as a financing tool. It is a procurement tool law, and people need to get beyond the conception that it is just for financing. He said it may allow some creative and innovative financing in a predictable, repeatable, consistent way but it is not to be confused with a financing tool—at least the way the Virginia model is set up.

Co-Chairman Jenkins recognized Representative Tolson, who asked if Virginia has done broadband public-private partnerships. Mr. Lloyd said they have had several proposed, and several of the smaller communities have done them; but most of them have relied on federal monies for those.

Representative Tolson asked if he saw the federal rule change clearing up some of the issues, and Mr. Lloyd said yes. He said there has been some broadband, but they have been part of a broader public safety effort to enhance the 911 system across the county rather than just a stand-alone broadband.

Representative Tolson asked if Virginia is where they want to be in broadband lines.

Mr. Lloyd said he was not a broadband expert, but he would say that there are a number of gaps in their rural communities. A study a year ago showed that in eastern, southeastern, and southwestern Virginia there are not only topography challenges but a lack of population density.

He said fortunately some of the stimulus money Virginia got is starting to fill in some of those gaps, but they still have a number of challenges.

Representative Ross said she understood that the Virginia model is more of a design-build model, which is definitely within the purview of this Commission, but the financing tools are also within the purview of this Commission because North Carolina is up against its debt limits, is looking at different ways of financing things, has significant constructions costs, has significant water and sewer needs, and has significant transportation needs. She said they would need to be in a both/and approach as opposed to an either/or approach. She asked why Virginia didn't pass a law about the financing and whether that is on the table for Virginia.

Mr. Lloyd said on the transportation side the Virginia statute is much clearer in allowing for innovative financing because those projects lend themselves more to toll financing and other outside private financing. And Virginia felt they could link up a very efficient procurement process with the financing tools already allowed in Virginia law. He said Virginia, like North Carolina, is a AAA bond-rated state, and their view of it was that they were open to private financing in some deals, but they haven't executed some of them because of the financial situation. For instance, he said they have several historic state office buildings downtown, and the state needs new office space. If the state were to redevelop those facilities, the historic state and federal tax credits mean nothing to a public entity. But if you could transfer that facility to the private sector for five years, they could get $10 million worth of tax credit and deliver that building for $40 million where it would cost the state $50 million. Once the recession ends, Mr. Lloyd said he thought people would be open to those kinds of deals

Representative Ross said it is easier to figure out a vehicle when it is something that has a consistent revenue stream because that revenue stream is something that is fee oriented. She said it brings up the question of who is in charge of increasing the fees, and that is something that has to be figured out. But if there is not a revenue stream, and it is something government would do just using taxpayer money, then there has to be some other sweetener in it that makes it something that would give the public sector some sort of additional advantage, for example the one-time tax credit. Mr. Lloyd said that statement explained it very well.

Co-Chairman Jenkins introduced the next speaker, who was Jim Copeland with Moseley Architects, a member of this Commission, who has spent the last 30 years planning school facilities throughout Virginia and North Carolina. He has built 60 projects in Virginia and 30 in North Carolina. Moseley Architects is one of the top twenty firms for educational design, and Mr. Copeland is the managing principal of the Raleigh Office and the director of educational planning. A copy of Mr. Copeland's presentation is available at the Commission's website in the 12-15-2010 folder: [http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.](http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121)

Mr. Copeland said he would share with the Commission some of his firm's experiences doing public-private work in Virginia. He said he spent the first 20 years of his career in Virginia, mostly dedicated to educational architecture and construction. For ten years he's been working in both Virginia and North Carolina, and for three years he has been living in Raleigh.

Mr. Copeland said the things he would be sharing would be focused on things that his firm has witnessed and experienced from a design and construction standpoint in the education arena as applies to public-private partnerships. He said they are a regional architectural firm doing work in Virginia, North Carolina, and South Carolina with two of their five offices in North Carolina. He said as you cross state lines different rules apply, and he would concentrate on Virginia.

Mr. Copeland said he is often asked why somebody in the educational arena would want to do a public-private partnership. He said he wanted to share two experiences with the Commission.

He said they did a high school in Chesterfield County, Virginia, outside the Richmond area, and they talked about the benefits of time. One of the county's issues was finding land quick enough to build their schools, and the public process by which they procured property was very slow and cumbersome. They went into a public-private partnership where the development teams were actually asked to look at property that was available and try to identify land that they would propose as part of their plans. So the developer went out and actually found land that they proposed to put these schools on as a part of the proposal to the school board. In that particular instance, it was believed that the school was completed about two years quicker than would have been possible under a normal procurement process. Time was an issue for that particular locality.

Mr. Copeland said T. C. Williams High School, which is up in Alexandria, was a very, very large and complex school. It was for 2,400 students and encompassed 450,000 square feet. The school had to be built on 22 acres, while the existing school of about 350,000 square feet was still there. So in one point of time, they had 22 acres with almost 1 million in square footage of school building. He said the school board said there was no way they could go out with a traditional bid process because they had to have a contractor with the expertise, the size, and the capability of being able to do the project well and on time. They went into a public-private partnership for the ability to find their contractor and bring him on board.

Mr. Copeland said Virginia does not have a CM at-risk process for K-12 construction that North Carolina does have. They have no way of marrying their A team together in Virginia for school construction. CM at-risk allows you to do that a little bit more here in North Carolina, but in Virginia they don't have that. As a sideline, he said T. C. Williams was the school where *Remember the Titans* was filmed with Denzel Washington, and there was real interest and importance in that community that that project be done correctly.

He said his firm has also had some small projects like the 911 Center in Fredericksburg, Virginia, which was 34,000 square. He said Fredericksburg had such a good experience the first time around, they sort of adopted the PPA process as their process.

In Roanoke, Virginia, Mr. Copeland's firm did a Multigenerational Recreational Center that had a private component to it. It was a facility that was built where they were going to generate membership dues that they were willing to share with the private entity that was going to build this facility and help to marry some of the financial advantages of that. He said the

Commission had discussed the benefits of public-private partnerships when you have a revenue producing type of building, and that was the emphasis in Roanoke.

Going back to Fredericksburg, Mr. Copeland said there was a high school and an elementary school that was needed two years ago, and they didn't have the political will for a referendum to finance that project. In the past they had had bad experiences with cost-over on some projects, and they wanted to go into a process where they knew what the building was going to look like, they knew what it was going to cost, and they wanted to know that they would not have a lot of change orders. And they wanted to know those things before they ever agreed to go into the project. Being able to do that was some of the benefit that they saw in the public-private process. He said that project did go through an unsolicited process by which they turned around and opened it up to other firms that wanted to come in. They RFQ'd, they short listed, they interviewed, and they narrowed it down to three firms. They selected Moseley Architects and they partnered with a contractor to build. They gave a guaranteed maximum price and did enough drawings so they could understand what program the school was going to get and what the school was going to look like. He said they entered into a comprehensive agreement for that project and then Moseley Architects worked with the contractor to make sure that everybody's objectives were met during the process. He said one of the concerns Moseley had as an architectural firm was the quality of construction they were going to get when the architect was getting paid from the contractor. Looking back now at all the public-private partnerships they did in Virginia, Mr. Copeland said he could match them up in quality with any of the schools they have done under the traditional process. He said their concern was unmerited, and the projects were of great quality.

Mr. Copeland said in the projects where Moseley was involved, the contractors had the ability to do a good job because they were not required to give projects to the low bidder. They could work with other contractors who they knew and they trusted to do a quality job. Therefore, Moseley has seen construction at a high level under that process.

When Virginia started thinking about the PPP process, there were a couple of myths about what it was. They thought there would be up to thirty percent savings in costs, and every speaker has acknowledged that this is not necessarily a less expensive way to build anything. Back when construction costs were on the increase of about five percent a year, that fact that a school could be built quicker under a PPP agreement did relate to cost savings because bidding a project two years later would bring on a ten percent increase in constructions costs. Mr. Copeland said if time is money, then this process can be less expensive, but that is certainly not the reason to do it.

With some of the large high schools being built, Mr. Copeland said there were those who thought maybe the private entities might want to come into those schools after hours. However, high schools are run from 7:00 a.m. to 10:00 or 11:00 p.m., and that myth was not the case.

Another myth was, "We cannot afford to build a school, so let's get the private sector to come in and do it." First of all, there's really no less expensive financing available than what the public sector offers. In Virginia there is the Literary Loan, the BPSO, and the BPSA money that is made available for school construction that is very inexpensive and very hard for the private financing people to compete with. He said as his firm went around and talked to developers about actually owing, operating, and maintaining school buildings, they asked why as developers would they want to own and operate a school building that doesn't generate revenue. As they talked to school people, asked why they would want someone else owning their building and give up control over who could walk into their school building.

As far as risk allocation, Mr. Copeland said you cannot move all of the risk to the development side and that is not the case. He said there is still risk in PPEA although some of it is shifted. He said there is not a pot of gold at the end of the rainbow either. It does cost money to do this, and there is no free money there.

Mr. Copeland said PPPs have given Virginia the ability in the educational market to pick their team and actually marry their A team. They can get the contractor and architect they wanted and they can work together. In the design-build arena, Moseley came together on day one with the contractor; they were a team when they went into the interview, and they were awarded the project based on their combined team. He said a lot of times they are hired by the school district as the architect and then they will sometimes be into the construction document phase before they'll bring on the contractor, which is kind of late in the game and you don't benefit from the true partnership that you would get from working with a contractor. From an architect's standpoint, Mr. Copeland thought it was great to design a school building when you've got the person who is actually going to build that school sitting side by side with you in going through the process. He said you do not get that benefit from a traditional design-bid-build process.

Mr. Copeland said they had done thirteen PPEA projects in Virginia, and all of them have been within the owner's budget, all of them were completed on time, and they had no or very few change orders. He said the quality of construction was good. A lot of times this process is considered best value. He said when you get the benefit of working with a contractor day in and day out, you get the benefit of value engineering decisions on a daily basis, so that process does provide a better value. Is it less expensive on bid date? Probably not; but at the end of the design-build or public-private partnership projects, Mr. Copeland said they were seeing a higher level of quality at costs that were still within the owners' budgets.

Mr. Copeland said many of their projects would not have been built if it were not for the public-private partnership process in Virginia. He said a lot of their clients love the idea of a turn-key project: "You as a developer design it, price it, build it, furnish it, and call me on dedication day." There are a lot less headaches in allowing one entity to be responsible for the coordination and efforts of all the different facets of getting a building completed. It is a very elaborate process, and as an owner, you have to have a lot of comfort and confidence in the team that you have selected because you are going to rely on their experience and their desire to do what is in your best interests. He said the collaboration is very important between the architect, the contractor and the owner.

Mr. Copeland said this is a very different process, and a lot of times this is outside the comfort zone of agencies. He said you have to have the confidence and the process in place to make it work well.

In managing expectations, Mr. Copeland said they found a lot of the school districts that had always done the traditional process needed to be educated somewhat on what design-build actually was so they understood that they needed to allow the team flexibility in the process and in the design to make it advantageous to them.

Mr. Copeland said again that the process does not necessarily save money, and it can be very complex. He said one of the things Virginia is trying to do is relook at the process to see how to streamline some of the agreement so that there is a smoother process in place. He said in some instances they scratched their heads and said, "We've got to get through the paperwork so we can design and construct a building."

Mr. Copeland did a comparison chart based on what he knew about Virginia and what he knew about North Carolina in the different bills to do a side-by-side comparison. He gave Virginia a design-build approach and North Carolina a construction-management or an option to lease approach. The way the bill was written is pretty flexible so whatever agreements are put in place, the owner has the ability to look at different aspects. Leasing is just an option, and in most cases (and all 13 of the PPP projects Moseley was involved in), there was traditional financing. There was no long-term ownership or leasing portion with that. He said Virginia does not have a Local Government Commission, so decisions are left up to the local county and the local financers to determine whether it is a viable project for them. Because it is a design-build, the GMP is initiated much earlier in the process, which clients really like. Mr. Copeland said every project they did was still bid, but they were not publicly bid, and there was no specific requirement to give those contracts to the low bidder. The contractors and the developers had the ability to match the quality of the work, the timing of the work, and the price of the work in the selection of their subcontractors. He said Virginia has a comprehensive agreement, and he said Mr. Lloyd already talked about the flexibility of project requirements.

In looking at things the Commission needs to be focused on, Mr. Copeland said everyone already understands that public-private partnerships work very well for revenue-producing types of projects. He said whatever they do should be flexible so that private developers have the ability to be ingenious about some of the things they are putting together. He said guidelines should be given to the LGC so they will know how to deal with PPP issues. And finally, he said the Commission needs to look at the public bidding laws in effect to give a little bit of latitude and flexibility to some of those.

In closing Mr. Copeland said the PPP process was not for everybody, but the experiences his firm has had with the school entities in Virginia have been very beneficial.

Mr. Klein said he agreed with Representative Ross that the financing component is a viable tool we can't deny, and they need to carve that out and make it understandable.

Mr. Klein said the second thing is that financing does not typically cost less, but in his experience the project can be equal to or less in cost than a traditional project on delivery day because value engineering saves money. He said he thought it was fair to say you that you could do a PPP project on equal footing.

Mr. Copeland said it was hard to qualify what are private costs at the end of the job. He said if you've had bad experiences and a lot of change orders, what Mr. Klein said is absolutely true.

Mr. Klein there was research done to give a comparison based on first cost of procurement and the end of the day cost that he would like to share with the Commission.

Mr. Copeland said most clients like knowing what the projects will cost on day one and not at the end of the project. And as long as the GMPs are within their budget, it's perfectly fine with them.

Chairman Jenkins said he and Co-Chair Ross were planning two meetings in January, and hopefully at the end of the second meeting the Commission will have decided whether they do or do not want to move forward some legislation; and if so, what the parameters ought to be.

Senator Rucho asked what the topics of the next meetings would be. Would they be looking at the other side?

Co-Chairman Ross said there were several folks who said that they would like to speak to the Commission, people in North Carolina who have concerns or want to make sure that the Commission does not go in a certain direction, and that would be the other side of it. She said they did not have a plan for a presenter to come from some other state and say, "Don't do it." But she said they wanted to invite stakeholders to come and talk for five minutes to share either what they like about this idea or some things that the Commission needs to be very aware of in going forward. She said she knew that the Treasurer's Office wanted to come and talk, and that would trickle down to the LGC issues. She said if anyone wanted to hear from somebody more than that, the chairs wanted to hear from Commission members about what else they want.

She said the idea was to have the next meeting during the second week of January and give that opportunity for people to come to the meeting and share their concerns. To the extent that we can process some of those at the end of the meeting, depending on how many people come forward, she said the Commission would start to do its work. There would then be another meeting where the Commission would decide on the things they would like to see in legislation or not.

Senator Rucho said the Commission had a great opportunity because there a number of projects that have been shown to the Commission with a track record, but there has to be the other side. He asked if our staff could find out whether there were some horror stories.

Co-Chairman Ross said Heather Fennell and Mark Bondo from staff have been asked to come up with some instances where PPPs have not worked out. She said certainly that could be presented at the next meeting.

Chairman Jenkins suggested that the staff poll a select group at random from the audience whether they are contractors, architects, engineers, or lawyers and see what is out there, and put together some sort of response to it, because you could end up with a real big disaster.

Ms. Shealey said one of the premise questions that she hears involves determining what the benefit is for North Carolina doing PPPs from both a procurement as well as financing perspective, and where would it be applicable in terms of pricing projects? She said it would be particularly helpful to at least understand what it is that the Commission wants to accomplish and whether there is a greater benefit for the PPPs. And, where is it most applicable for projects in North Carolina?

Representative Tolson said he would like to see the broadband issue added to the discussion because discussions have already been started with private entities and local governments on broadband, but they fell by the wayside. He said he was not sure there was enough time to cover that topic the way it should be covered, but in looking at a law on public-private partnership, broadband certainly should be a part of it.

Mr. Vick said he agreed with Ms. Shealey that it was important to think about what the Commission wants to accomplish. He said he worked for S. T. Wooten, a highway contractor, and as a member of the Association of General Contractors, he had been to a meeting where this issue was presented. He said several things came to mind that were important to his company. (1) They were looking for new and consistent revenue streams, or ideas to bring revenue to the table. (2) They wanted to maintain a fair and open process. He said North Carolina is fortunate in having a transparent, fair, and open low-bid process and they wanted to maintain the process and use the rules and laws that are in place. (3) His company opposes unsolicited bids because they think it is the opposite of a fair and open bidding process. He said it was hard to imagine somebody doing a bid without doing the groundwork with somebody ahead of time to make sure that it at least had a chance to succeed, and that led to a lot of back and forth backroom discussions that would not be in the best interests of the public, themselves, or anyone else. He said no matter what happens, the public has to buy into it and believe in it. (4) His company supports making sure local firms in North Carolina have a fair and equal opportunity to compete because they pay taxes here and hire employees here. He said from his own experience, when projects get beyond a certain size, they don’t see local firms winning the contracts or local subcontractors participating.

Chairman Jenkins said Mr. Vick gave glowing examples of why projects should be divided into smaller pieces so as to share the wealth.

Chairman Jenkins said the Commission members would be polled for a suitable date for the next meeting, and the Commission adjourned at 11:36 a.m.

Respectfully submitted,

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Senator Clark Jenkins, Presiding Co-Chair

Margie K. Penven, Committee Assistant