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A West Coast Initiative

CASCADIA CENTER

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Seminar Issue Brief

Lessons in Public-Private Partnerships & Climate Change: What British Columbia Taught California & What Washington Can Still Learn

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AS IN YEARS PAST, the 2007 Seattle Chamber of Commerce Leadership Conference is being held in Vancouver, British Columbia. It is especially appropriate that global climate change is this year's conference theme. We are fortunate to be in a part of the world steeped in leadership on this critical issue. Washington's Governor Christine Gregoire, California's Governor Arnold Schwarzenegger and British Columbia's Premier Gordon Campbell have all worked to push this issue in their respective states and are each widely recognized for their efforts.

For a variety of reasons, however, British Columbia has been a leader in an area where Washington State has been deadlocked: **leveraging private equity funding to enable public investment in infrastructure that enhances environmental sustainability and economic vitality.** California, Washington's giant neighbor to the south, has six times the population and consequent infrastructure challenges as Washington. But the Golden State, under Governor Schwarzenegger's leadership, has taken note and learned valuable lessons from B.C. and Premier Campbell. The story of those lessons can and should be heeded by Washington's leaders.

BRITISH COLUMBIA SUCCESS STORY

THE STAR POWER OF California's Governor Arnold Schwarzenegger follows him wherever he goes. As he toured British

Columbia at the end of May 2007, provincial officials praised him as a statesman they could emulate. Schwarzenegger returned the compliment at the construction site of a major new infrastructure project being built for the 2010 Winter Olympic Games.

In May, Schwarzenegger, along with Campbell, visited **Canada Line's** new rapid transit rail tunnel, which will connect Vancouver's waterfront to its airport.



At the site, workers were boring the tunnel for a type of public works project that Schwarzenegger has been unable to launch at home: one owned and operated entirely by a private company. The 12-mile rail line that will connect the Vancouver waterfront and airport is one of dozens of such ventures in Canada. Indeed, the provinces are turning to private companies to build and operate trains, roads, public hospitals, university facilities and local schools. "The way they do it is...the right way to go," Schwarzenegger said in an interview. "We don't have to exactly copy it, but we can learn from those ideas."

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The public-private partnership (P3) approach is expediting construction of the Sea-to-Sky highway, the Portman and **Golden Ears Bridge**, and Canada light rail. British Columbia has saved significant taxpayer money, streamlined construction and accelerated project completions through public-private partnerships for major infrastructure. Campbell has briefed Schwarzenegger and senior California state officials on B.C.'s success, and the California governor looks to similar financing and partnerships for his state's Strategic Growth Plan, a \$43 billion capital investment package passed in November 2006.



"I love visiting projects like this because they show what can be accomplished when the public and private sectors work together," said Schwarzenegger during the May visit. "These trains will reduce congestion, reduce pollution, lower commute times and put a world-class transportation system in place for the 2010 Olympics. It is a fantastic example of how the availability of private capital can help governments achieve their infrastructure goals faster and at a lower cost."

British Columbia's government owns Partnerships BC (PBC), an independent organization that evaluates and implements financing and construction of major infrastructure projects. PBC uses a number of financial models for projects, including traditional bond financing, vendor financing and public-private partnership financing.

"Public-private partnerships have been a tremendous success in British Columbia, resulting in millions of dollars in additional benefits to over 20 projects, including critical

transportation and health care infrastructure," said Campbell. "P3s take advantage of innovation and expertise of the private sector, while reducing risks and delays. P3's will be fundamental to B.C. meeting our infrastructure requirements. We plan to expand on the successful P3s completed or under construction in our province."

Also in B.C. is the **Hydrogen Highway**, a voluntary network of technology companies and institutional partners showcasing a growing roster of hydrogen and fuel cell technology demonstration projects in the province. These include: a) five advanced prototype Ford fuel cell vehicles being used in daily business operations by public and private sector; four Translink (Vancouver regional) transit buses powered by heavy-duty hydrogen and compressed natural gas processed after capture from a North Vancouver hydrogen waste stream; c) conversion of eight light-duty GMC Sierra trucks to run on compressed hydrogen gas in modified internal combustion engines.

FORMULAS FOR SUCCESS

SUCCESSFUL P3 MODELS CAN HELP new projects by providing the experience that will attract qualified private sector teams. Also, a legislative framework must give the respective lead agency proper contracting authority. Ideally, a qualified public entity will champion the project and manage procurement.

Factors Driving Use of P3 Model in Canada, Europe, Australia and Asia:

- Inability to publicly finance costs
- Long implementation times in public construction schedules
- The risk or fact of cost overruns

Goals and Key Features of Successful P3 Models:

- Public goal: provide a safe and functional transportation service
- Private goal: delivery service through model giving return on invested capital
- Risk transfer: assumption by private entity of risks within their control

- Risk management: creation of strong cost-control incentives through fixed-price contracts
- Funding leverage: an enhanced menu of options to "mix and match" funding sources and obtain the most favorable leveraging of public money
- Hand-over: infrastructure is returned to the public entity at the end of the private concession period

THE LOGIC OF P3's

SCHWARZENEGGER LAUDED B.C.'S APPROACH, noting the significant benefits that use of such a model could bring to California's taxpayers. The level of private financing secured and savings realized by Partnerships BC would be equivalent to California receiving more than \$32.5 billion of additional infrastructure financing over four years—\$8 billion more per year. It would also enable California to achieve \$2.5 billion in value savings on the lifecycle costs relating to the \$43 billion in State General Purpose bonds approved by state voters last year.

Currently, private infrastructure funds shun California because of the overly complex and uncertain nature of its infrastructure financing laws. Schwarzenegger is aggressively pursuing these options for California as a way to overcome bureaucratic process delays. Resistance comes from legislators who hesitate to contract work traditionally done by public employees. Another fear is that private investors will gouge the public by excessive charges for use of the facilities. The second concern can be addressed by providing that the public agency retains authority to set user fee levels.

The amount of "profit" gained by a private operator can become a political focus. But the crucial test for measuring the public benefit of a P3 is whether the total cost and level of cost exposure compare favorably with other approaches. By these criteria, a P3 can often deliver a greater public benefit than available alternatives. Through contract provisions, the public agency can control the amount of money paid to private operators, not

only by placing a ceiling on construction cost reimbursement but by retaining authority to set tolls during the operating life of a facility.

The unique value of P3's in infrastructure projects lies in their ability to deliver cost and time savings, based on specific mechanisms that deliver superior results. P3's enhance the efficient use of public funds in building key projects by having private teams compete to deliver the most cost-effective solution for goals defined by the public sector.

P3's provide a way to deliver a win-win by dividing the risks between taxpayers and investors in ways that play on the strengths of each sector. In a P3, each area of risk is carried by the entity most able to control it. The private entity is the lead on risks related to construction costs, schedule, quality, and conditions on the ground and the public entity is the lead on the EIS and public involvement process.

Private risks are "priced" and backed by private equity capital, creating a powerful incentive to effectively manage factors such as cost and schedule overruns during construction, and operation, maintenance and repair costs after construction. Governments have structured their contracts so that if a project is not completed on time or fails to provide the promised level of service, investors rather than taxpayers get stuck with the bill. Most projects in Canada include such provisions. "It is very rare that they come in late or over budget. If they do, the private company eats the costs," said Jane Peatch, executive director of the Canadian Council for Public Private Partnerships.

P3s provide discipline in another key area: preventing the shift of public funds away from maintenance during operations, resulting in deferred maintenance that leads to the shortened useful life of assets, reduced performance, and greater life-cycle costs. Maintenance requirements are evaluated, incorporated and managed from the inception of the project. This makes it more likely that the life cycle costs of a project will be fully taken into account and funds identified to cover them. Such planning is a frequent gap in traditional public procurement.

THE OUTLOOK FOR WASHINGTON

THERE ARE LESSONS that Washington can learn from California's experience. Indeed, if the problem in California is overly complex laws and bureaucratic delays, in Washington State one key challenge is **a complete lack of enabling legislation that would authorize P3's.**

That said, **Washington has much it can bring to the table**—opportunities for success that are unique to the state. Indeed, Washington has Governors Gregoire, Locke, and legislative leaders to thank for having the political courage and leadership to support a gas tax that brought in \$15 billion in new revenue. The state is in the unique position of having the **opportunity to use local union pension funds and public employee pension funds to supplement private equity capital** to help fund critical projects.

The potential for a public agency-labor alliance or (in the case of pension funds) a public-public partnership, is an important consideration in a state that has banned most P3's. To eliminate arguments about excessive profits in the pockets of outside investors, Washington can and should consider this option to solve infrastructure project challenges.

In such a scenario, the goal is not to have foreign investors make huge profits and set higher toll rates. Instead, it makes tremendous sense to encourage a situation where the men and women who actually build the infrastructure share in its investment. The other result is that the public retains control over toll rates. "Pension funds are patient funds (for the members and the public)," said former U.S. House of Representatives Majority Leader, Dick Gephardt, at a Cascadia forum last year. They are a "fifty year return on investment."

Large, international construction firms and foreign banks have dominated the private sector partnership world. Now, local labor unions like the Northwest Building Trades and state public employee pension funds like the giant California Public Employee Retirement System justifiably want to be involved. Washington is in the unique position to

facilitate that. And there would be plenty of places to try, such as with a deep-bored tunnel through downtown Seattle. Cascadia provided a partial blueprint for the project concept in an August 10, 2007, op-ed in the Puget Sound Business Journal.*

"A deep bored tunnel through downtown (Seattle) to replace the viaduct...would segregate local traffic from through traffic, and would avoid the construction disruptions on the central waterfront that threaten business. Obayashi Corp. is building a deep twin-bore tunnel in Seattle right now for Sound Transit's light rail line...."

"Our plan would redesign the reversible express lanes from Northgate to downtown. We would eliminate the notorious backup caused when the lanes "switch" from north to south by designing an additional "contra flow lane" in the opposite direction. This would allow the express lanes to operate 24 hours a day in each direction and provide an additional through lane in the difficult downtown area, which currently has only two through lanes....For this premium service, a variable toll would be charged for the express lanes only; drivers could still access the regular lanes free. We'd dedicate a portion of the toll to expand bus rapid transit options as a supplement to current transit investments on I-5 and Highway 99."

"How do we pay for such a feat of engineering without added taxpayer exposure? ***Answer: In addition to tolls, union and public employee pension funds could be invested in these projects and would pay back a return over many years.***" (emphasis added) Cascadia Center op-ed, Puget Sound Business Journal, August 10, 2007

Washington can do much better and should heed the lessons from B.C. and California. But it can also teach the rest of the world a thing or two about tackling complex challenges. The state has all the right ingredients for success; **it's time to step up to the plate.**

**Cascadia Center will be sharing these and related concepts with the Washington State legislature at the beginning of the 2008 legislative session.*