Black & Veatch Insights Group

WATER INDUSTRY REPORT

2017

STRATEGIC DIRECTIONS

BUILDING A WORLD OF DIFFERENCE®

BLACK & VEATCH

Sustainable Water Supply

BEYOND FINANCING: KEY ATTRIBUTES OF A PUBLIC-PRIVATE PARTNERSHIP

By Bruce Allender and Francesca McCann

Public-private partnerships (P3s) are commonly associated with the financing of large-scale projects that a utility can't otherwise afford. While a P3 can be used in this instance, other key attributes in the P3 model merit consideration in a variety of circumstances.

In a P3 structure, the private entity may provide the financing, but the true benefits of the partnership structure go well beyond financing alone. These benefits include the following:

- Economic development and job creation
- Rate predictability and stability
- Predictability around asset maintenance
- Optimal risk allocation

Life cycle cost management and long-term partnerships can help a utility manage the affordability of its services to its customer base. This can be done through a system, program or project-wide approach. The long-term partnership should be structured to include economic goals for the community along with key performance indicators (KPIs) to deliver system improvements through a program approach or through a specific project as part of its capital program through the P3.

P3s can help solve some of the greatest challenges faced by water/wastewater utilities. Of the top five most important challenges revealed by respondents to the *2017 Strategic Directions: Water Industry Report* survey, P3s can directly help solve all five: aging water and wastewater infrastructure, managing operational costs, system resilience, managing capital costs, and justifying capital improvement programs (CIPs) and/or rate requirements (Figure 6).

ECONOMIC DEVELOPMENT AND JOB CREATION

There have been several examples where P3s have spurred economic development and job creation. In the case of Rialto, California, the city went from bankruptcy talks in 2012 to a strong fiscal condition by 2016. Rialto's public-private solution generates new jobs, infrastructure and $2 to $3 million in annual payments. The Rialto partnership's investment in the water and wastewater CIP resulted in over 400 jobs directly, and the partnership's upfront economic development funding enabled a major redevelopment effort for the city that has created 4,450 new jobs to date, with another 4,000 scheduled to come online over the next two to three years.

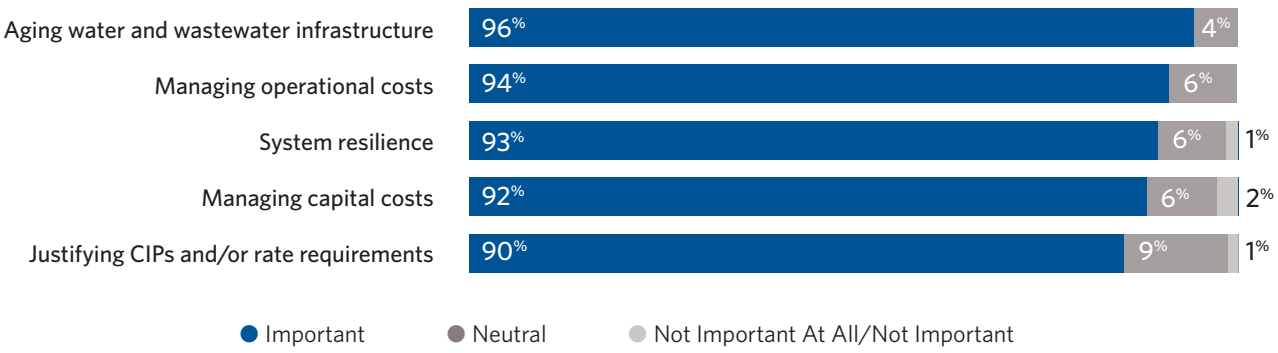
In Maryland, Corvias Solutions' Clean Water Partnership with Prince George's County to retrofit up to 4,000 acres of impervious surfaces using green infrastructure is another example. The partnership recruits local disadvantaged businesses and provides access to training and work experience. Overall, the partnership is designed to spur local jobs and economic development, while meeting a regulatory requirement.

"The partnership ensures that the city's water and wastewater infrastructure is upgraded and run in the most cost-efficient manner, while also laying the groundwork for new economic development."

MIKE STORY
RIALTO CITY ADMINISTRATOR

FIGURE 6

Please rate the importance of each of the following challenges to the water/wastewater/stormwater industry.



Source: Black & Veatch

SAN ANTONIO – PROTECTING THE RATEPAYER

The financial structure of the Vista Ridge P3 sets a flat rate for the 30-year contract period. In most P3 projects, rates increase over time as population, usage and inflation increase. In the case of the Vista Ridge P3, SAWS maintained that what was critical for them was a structure that provided "tomorrow's water at today's price." This type of structure is unique to a P3 project (including non-water P3s) and illustrates the flexibility of the P3 model.

AFFORDABILITY, RATE PREDICTABILITY AND STABILITY

One of the benefits of a P3 model is that it allows the utility to contractually obligate the private party to keep rates consistent in the long term. This allows rate stability and protects ratepayers from unpredictable, dramatic increases over the life of private sector involvement in the project. This year's report found that over 50 percent of respondents said they would likely consider a P3 if they could have a predictable and stabilized rate structure, while decreasing life cycle and operation and maintenance costs.

In the case of the Rialto P3, the structure yielded a significant initial jump in rates, 115 percent over five years, followed by anticipated long-term rate stability throughout the 30-year period. In the San Antonio Vista Ridge P3, San Antonio Water Systems (SAWS) took an innovative approach to rate structuring, obligating the private partner to maintain a flat rate throughout the life of the project.

ASSET MAINTENANCE PREDICTABILITY

In this year's survey, over 55 percent of respondents said they have adopted or are considering a P3 to gain certainty in asset investment. Likewise, the most critical sustainability issue for water utilities is maintaining or expanding asset life. With a long-term (generally 30 years) project structure in place and agreed-to KPIs, assets can have a structured, predictable maintenance plan. Moreover, often the long-term maintenance costs are notably lower in a P3 than under a traditional model because of an integrated delivery approach that includes enhanced planning and better efficiencies. The total cost saving for the life cycle of the asset can be between 10 and 30 percent compared to the traditional delivery model.

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FAIR AND OPTIMAL RISK ALLOCATION

One of the primary advantages of adopting the P3 model is the ability of the public partner to transfer agreed risks to the private sector. The public partner has the option to negotiate which elements of financing, technical, construction and operating risk are borne by the private sector. In the case of the Vista Ridge P3, SAWS was able to contractually allocate regulatory risk onto the private partner. In the case of the Rialto P3, the contract was structured to allow performance risk to shift from the city of Rialto to the private party over time. The opportunity allowed under the P3 model for the public partner to transfer risk to the private sector can't be overemphasized.

CONSIDERATION OF THE P3 MODEL

In the U.S., P3s are still a developing approach, and it appears that many utility directors are more comfortable implementing specific projects than system-wide P3 approaches. However, several successful system-wide P3s that deliver capital projects through a mix of alternative and traditional delivery methods have been implemented.

Of the survey respondents who are currently using or considering a P3, more than 60 percent said they are using it for a specific project, which are now diversifying in nature. Initially, utilities considered P3s for water and wastewater projects/systems; however, in recent years, P3s are now being considered for stormwater, combined sewer overflow, septic-to-sewer, irrigation and other challenges.

P3S VERSUS PRIVATIZATION

It is important to distinguish P3s from outright privatization. Privatization implies selling the entire assets of a given entity, while through a P3 the government entity retains ownership of the assets: facilities, pipes, rights-of-way, pumps, etc. Depending on the agreed-upon structure of the deal, the government can then turn over the operations, maintenance, investment and/or finances of the organization. P3s are truly a partnership between the public and private sector, not an asset sale.

P3 FINANCING MODEL GAINS MOMENTUM

"P3s are only about the financing" is one of many myths about P3s that is important to dispel. Financing can be, but isn't necessarily, a critical component of a P3. While a P3 is not a one-size-fits-all solution, use of the P3 model can provide a workable, flexible option that aligns interests and provides a critical solution to some of utilities' most pressing problems.

Education and persistence will be the two biggest factors in greater adoption of the P3 model. As more utilities actively engage with the private sector to explore the P3 model, the more likely that greater adoption of P3s will continue to advance.