New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 255—NO. 86
THURSDAY, MAY 5, 2016

Outside Counsel

Expert Analysis

Enabling Public-Private Partnerships in New York

By Patrick O'Sullivan

The need for greater investment in the New York metro region's inadequate infrastructure system is increasingly apparent. High-profile examples of such inadequacy such as LaGuardia Airport, Penn Station and the Hudson River rail tunnel as well as systemic weaknesses exposed by Superstorm Sandy underscore the urgency for investment. As one demonstration of the public sector's realization that more infrastructure investment is necessary, New York City Mayor Bill de Blasio in February announced a $2.5 billion plan to develop a streetcar system in transit-underserved Brooklyn and Queens waterfront neighborhoods.

A majority of states have enacted public-private partnership enabling statutes to provide a framework that guides the public and private sectors in working together on capital projects such as a new streetcar system. Many states have found that a statute creates significant value because it demonstrates the public sector's commitment to partnering and because the resulting framework leads to certainty and transparency with respect to the procurement process. Given the growing infrastructure challenges faced throughout the country, greater use of the public-private partnership framework, particularly when leveraged with some form of tax-exempt financing, would better position the public sector to undertake such critical capital projects.

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Public-private partnerships encompass a wide range of contractual relationships between the public and private sectors for everything from infrastructure construction to real estate development to the provision of services. States typically enact public-private partnership statutes to address infrastructure projects or public facility construction projects. In these contractual relationships, the private sector may undertake some or all of the following: design, construction, financing, operations and maintenance of capital projects.

In the case of design-build, which is the most basic form of a public-private partnership, the public sector undertakes one procurement for design and construction at an early project stage. The public sector contracts with one private sector entity, which enables the design and construction teams to work closely together in an integrated manner throughout a project.

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In the case of the more traditional design-bid-build approach, the public sector undertakes the sequential steps of procuring a company to first fully design a construction project and then procuring a contractor to construct the project based on the completed designs. As noted by the Center for American Progress in its report "P3 – Understanding Difference Between Procurement and Finance," the design-build arrangements create value for the public sector by facilitating the shift of budget and completion risks to the private sector, which takes on such risks because the structure provides the selected entity with the ability to manage both design and construction and with the latitude to decide on how to best achieve project requirements.

Enabling Statutes

Given the potential value of structuring projects through broader public-private partnerships, 33 states, not including New York, as well as the District of Columbia and Puerto Rico have passed enabling legislation. The need for such legislation may not seem obvious since the framework primarily focuses on procurement, which would not appear to require legislative action. But enabling legislation: (i) demonstrates a state's commitment to working with the private sector to deliver projects; (ii) removes any uncertainty regarding the legality of partnerships; and (iii) establishes a structure that leads to transparency and reduced transaction costs. Since structuring such contractual arrangements requires significant up-front resources, prospective private sector partners look to expend resources in jurisdictions where they know that the public sector does not need to seek additional legislative approval for a contract or procurement, which a statute typically addresses.

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Additionally, a statute can protect a project utilizing a public-private partnership from legal challenges that may arise after execution. Many statutes enable the public sector to make procurement decisions based on the "best value" offered by a bid instead of simply the bid with the lowest cost. While providing valuable flexibility in terms of the procurement process, such an approach is difficult to undertake without a statute since the public sector may face limitations in making decisions based on criteria other than lowest cost. In New York State, for example, the New York Highways Law requires that a state agency award construction contracts for highway construction to the lowest bidder.

Finally, through development of a consistent approach fostered by such statutes, the public sector has the ability to educate its constituents as to the process undertaken for making project decisions and can learn from each procurement and share expertise across agencies.

Not surprisingly, states have developed a variety of approaches to public-private partnerships through enabling statutes. In an effort to promote both the broader adoption of statutes and to foster a more unified approach to partnerships, the Bipartisan Policy Center, a non-profit based in Washington, D.C., proposed model legislation in December 2015.

The model's key components include: (i) allowing partnerships for a wide range of projects beyond traditional infrastructure work (e.g., broadband infrastructure, ferry transportation); (ii) creating a state office dedicated to providing public-private partnership assistance to state and local agencies; (iii) standardizing and promoting best practices; and (iv) incorporating a process for public engagement.[1] While a public-private partnership may not in and of itself require private investment in public infrastructure, it can provide the framework for utilizing multiple sources of capital.

New York

New York State is currently one of the 17 states without a public-private partnership statute. While the state passed the New York State Infrastructure Investment Act in 2011, which allows for the use of design-build procurement, only five state agencies can make use of such procurement, and the statute does not apply to municipalities and their agencies. In the instances where the state has utilized design-build procurement, the results have been significantly positive. Most prominently, the state has used this approach with respect to the New NY Bridge project, which is the twin-span replacement for the 3.1-mile Tappan Zee Bridge.

The state estimates the bridge replacement to cost $3.98 billion, which is approximately $1.7 billion less than initially estimated, and construction remains on schedule with completion expected in 2018. The state has also used this approach in connection with the replacement of the Kosciuszko Bridge, which as part of the Brooklyn-Queens Expressway experiences approximately 160,000 car trips a day. The state estimates $445 million in cost savings and 3.5 years in schedule savings with respect to this $550 million project as a result of the design-build approach.

Given the state's positive experience with projects such as the New NY Bridge, on March 31 as part of enacting the annual budget the state passed the Transformational Economic Development Infrastructure and Revitalization Projects Act. The legislation provides the Empire State Development Corporation and its subsidiaries with design-build authority for redevelopment projects involving the Javits Convention Center and Penn Station. To address concerns raised by labor organizations with respect to the expansion of the design-build approach resulting in the decline in the use of union labor and an erosion of labor protections, the act allows for such contracting provided the contractor executes a project-labor agreement with a construction trade labor organization in connection with the project.

The New York metro region has critical infrastructure investment needs, and public-private partnerships, even in the most modest form of design-build procurement, would provide a means to better address these needs on a local level. The Center for Urban Future estimates that the city has approximately $47.3 billion infrastructure repair needs and a $34.2 billion funding gap over a five-year period.[2] To date, the city has been limited in its ability to undertake infrastructure projects in a truly efficient way.

In a review of 20 ongoing New York City Department of Transportation projects representing $3.8 billion in work transportation projects undertaken through the traditional design-bid-build approach, the Citizens Budget Commission found that 14 have experienced some length of delay and 19 have experienced cost increases, and, with design-build procurement, the commission estimates that the city could save some $2 billion over 10 years.[3]

While there have been efforts in the state Legislature to provide municipalities in New York with the ability to utilize design-build procurement, such legislation has yet to be passed. In May 2015, a bill titled the "New York City Public Works Investment Act" was introduced in both the State Assembly and State Senate. The bill would enable seven city agencies and authorities to utilize design-build procurement including selections based on "best value" of proposals. To address any potential concerns raised by labor groups, such procurement, as is the case with the Transformational Economic Development Infrastructure and Revitalization Projects Act, would be available for projects with a project labor agreement. The proposed legislation remains with the Cities Committee in both chambers of the Legislature.

Financing

While the United States has witnessed growth in the formation of public-private partnerships, it continues to lag behind other countries in use. The existence of tax-exempt financing, which is not prevalent elsewhere, is often cited as a main cause for why a relatively small portion of the public sector utilizes such partnerships. The U.S. municipal finance market is an approximately $3.7 trillion market and in 2015 there was just over $400 billion in new tax-exempt issuances.

Given the robust market, many public sector participants see limited value in the use of public-private partnerships, particularly given the misunderstanding that such partnerships are meant to transfer responsibility for project financing to the private sector. From a financing perspective, access to tax-exempt debt allows the public sector to fund projects at a lower cost than the private sector can. A public-private partnership needs to be understood for what it truly is however, which is a contractual framework that allows for the transfer of certain risks the private sector is more adept at managing, such as cost overruns and scheduling. When viewed in this manner, public sector participants should seek to use such partnerships even in the case of projects being financed with some form of tax-exempt debt.

Public-private partnerships, when combined with some form of tax-exempt financing, offer the public sector a cost-effective means of addressing their infrastructure needs. In the most basic contractual form, design-build, the combination of such a contractual arrangement and tax-exempt financing, provides the public sector with a more efficient way of designing, constructing and financing projects. Additionally, the public-private partnership framework has the flexibility to enable the public sector to address longer-term matters such as operations and maintenance and even the potential to attract private investment alongside tax-exempt financing. For such projects, the public sector can look to qualified private activity bonds since the increased private sector involvement in terms of operation and maintenance limits the use of traditional tax-exempt bonds.[4]

As an example, in 2013 the Port Authority of New York and New Jersey entered into a 40-year design-build-finance-maintain contract with NYNJ Link Partnership, a private sector consortium, to replace the Goethals Bridge. The $1.5 billion project is being funded through a combination of tax-exempt private activity bonds, a federal Transportation Infrastructure Finance and Innovation Act (TIFIA) loan and developer equity. It is worth noting that the Port Authority can undertake such public-private partnerships because as a bi-state agency it is not subject to New York State procurement laws. Realizing the potential value of the combination of public-private partnerships with tax-exempt financing, the Obama administration proposed the creation of Qualified Private Infrastructure Bonds as part of its FY2016 budget.

These tax-exempt bonds would be structured like private activity bonds but would not be subject to a volume cap limitation nor the alternative minimum tax as private activity bonds are. While ultimately not part of the FY2016 enacted budget, the proposal, which the administration again proposed for the FY2017 budget, demonstrates one potential way public-private partnerships and tax-exempt financing could be combined.

Public-private partnerships can provide real value to the public sector in addressing its overwhelming infrastructure needs. As a city that continues to grow with an infrastructure that continues to age, New York City would benefit significantly from such a tool to address needs ranging from repairing existing roads to expanding the transit network with streetcars and ferries to building out its technology infrastructure. When coupled with the municipal finance market, the city would be better positioned to address its infrastructure challenges and remain an economic engine.

1. Bipartisan Policy Center, "Public-Private Partnership (P3) Model State Legislation," December 2015, p. 3.

2. Center for an Urban Future, "Caution Ahead: Overdue Investments for New York's Aging Infrastructure," March 2014, p. 11.

3. Dague, Jamison, "Design-Build Contracting: A Way to Fix More Bridges for Less Money," Citizens Budget Commission, 18 Feb. 2016.

4. For projects involving private operation, qualified private activity bonds are tax-exempt bonds issued by a state or local government where proceeds are used for a qualified purpose under the Internal Revenue Code but where the limits set forth in either the private business tests or the private loan financing test of the Code are exceeded.