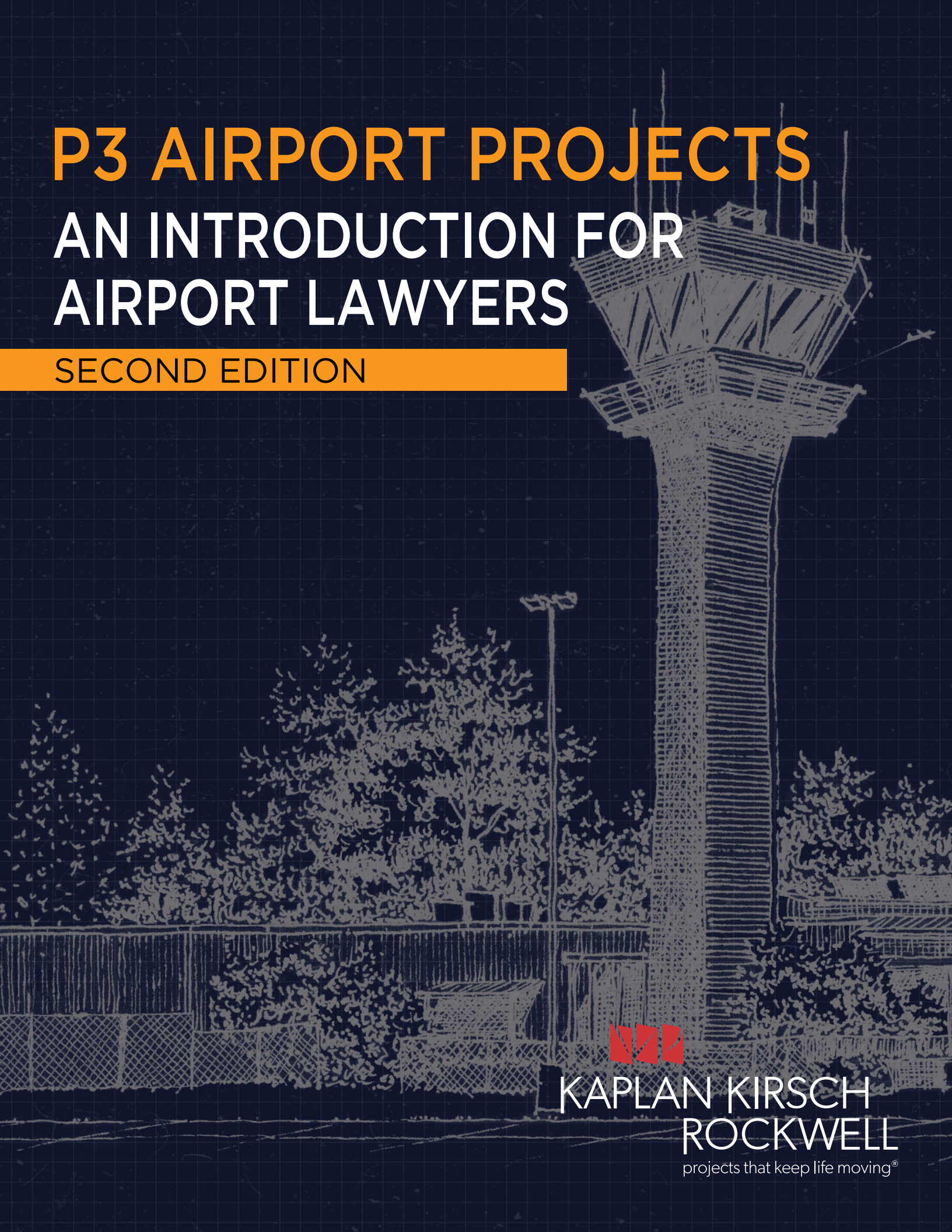
P3 AIRPORT PROJECTS

AN INTRODUCTION FOR AIRPORT LAWYERS

SECOND EDITION



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P3 Airport Projects: *An Introduction for Airport Lawyers*

This short guide is intended as background reading for airport lawyers who are interested in learning the basics of airport public-private partnerships (P3s), about various P3 approaches, and about recent P3 airport activity in the United States.[1] Nevertheless, this guide should serve as a foundation to inform internal discussions and to prepare for more detailed conversations with potential private sector partners. Note that at the end of the guide is a list of resource materials that may be instructive when preparing for such discussions and conversations.

A P3, in the broadest sense, is nothing more than a contractual relationship between a public entity (an airport sponsor or proprietor in this context) and a private sector entity or entities that allocates responsibility for delivery of services, investment of capital, and assumption of risk. The underlying principle of any P3 in the transportation realm is that by leveraging the respective skills and assets of the public and private entities, it should be possible to improve the efficiency by which transportation functions are provided. While any contractual relationship between a public and private entity could be called a P3, the use of the term P3 in this manner can result in confusion given the longstanding role of the private sector in operating airport concessions and in developing and operating airport-related projects. As a result, in the U.S. airport context, the term P3 is most often used to refer to an arrangement by which services or investments that traditionally have been provided by an airport sponsor are instead provided by a private sector entity.

The scope and terms of any airport P3 must be carefully tailored to each airport's unique operating and financial environment.

Across all traditionally public segments of the transportation sector, P3s in the United States have, until recently, been viewed by the public, as well as certain public officials, with some degree of skepticism. A number of early prominent efforts at P3s were characterized as outright sales of public assets.

Several toll roads failed (in that their private operators filed for bankruptcy) and had to be taken back by a public agency. In the U.S. airport industry, early discussions similarly focused on full airport privatizations (modeled on similar transactions in Europe), as, for example, under the FAA's statutorily-authorized Airport Privatization Pilot Program.[2]

Over the past several years, U.S. P3 structures have evolved in the airport environment. They have begun to find a balance between adhering to the core interests of the public entity and engaging productively with the private sector. Airport P3s are more often targeted to specific development projects where significant capital is needed or risk is to be allocated – such as the various terminal projects at JFK and LaGuardia, the Great Hall project at Denver, the privately developed ultra-low cost carrier terminal at Austin, or the privatized terminal at Paine Field in suburban Seattle.

I. IDENTIFY PROJECT GOALS

In considering a delivery system for a potential project, one of the most important questions for a public entity to ask is "*What are our goals, and in light of those goals, why should we consider a P3 structure instead of a traditional project delivery, procurement, and financing process?*"

While a P3 can be very helpful in certain circumstances, it is neither a panacea nor a source of free money. P3s can also create certain liabilities for the public entity that need to be addressed. Being thoughtful in understanding the public sponsor's goals for any project and the reasons why it might want to consider a P3 structure is a vital element in the success of any project.

Public entities choose P3s for a variety of benefits that are applicable to the airport context, including:

- *Project delivery* – can improve efficiency and save time and money;
- *Project procurement and innovation* – can promote competition not only on cost, but also on alternative design and technical considerations;
- *Risk allocation* – can transfer certain risks to the private sector developer/concessionaire;
- *Accountability* – can provide a single point of responsibility for all elements of project delivery;

- *Financing alternatives* – can be more flexible where there are cash flow or borrowing capacity limits of a public entity. Additionally, private capital (both equity and debt) can be used to bring additional financial discipline to a project;
- *Customization* – can increase the ability to customize contract terms to address specific project and authority concerns (including the adaptability of private sector counterparties for non-standard terms);
- *Limitation on recourse and financial risk exposure* – can reduce financial risk; even though a failed P3 project will have adverse consequences for the public agency, those consequences can be reduced (relative to a traditional public project) so that, in the most extreme case of a developer default or bankruptcy, a material portion (and potentially all) of the financial loss that would otherwise be retained by the public sector will be borne by the private sector;
- *Long-term maintenance* – can provide for long-term maintenance; often long-term operation and maintenance of a facility is included in a P3 structure, providing a long-term commitment to specified standards at a known, fixed cost for the foreseeable future; and
- *Addressing life-cycle cost issues* – can package design/construction with operations/maintenance responsibilities to optimize the delivery of both.

Notwithstanding these benefits (not all of which, of course, are available for every P3 arrangement), there are risks to the public entity in any P3 arrangement. Therefore, it is particularly important early in project planning to define the reasons why (and what kind of) a P3 path is being considered. P3 projects pursued without either clear goals or a clear understanding of the technique can be problematic, and result in performance below expected standards.

Risk allocation is often one of the driving forces behind many airport P3 efforts.

A public entity's own internal capabilities are essential for making a P3 approach successful. While many agencies focus on the initial P3 procurement, it is equally important to be attentive to internal capacity over the entire term of the P3 arrangement. Long-term success is absolutely dependent upon the public agency's ability to provide robust ongoing contract administration (during the construction period), and oversight of operation and maintenance over the entire contract period. Contract management expertise and discipline are crucial beginning with the initial pursuit of a P3, because a successful procurement is built upon an understanding of (and preparation for) future project management challenges. Therefore, a public entity must understand that a P3 approach will not eliminate internal administrative costs (though they may be different or lower). The likelihood of success could be seriously undermined if the public entity fails to ensure that that internal capacity is available – from the beginning of the project.

II. TYPES OF P3 ARRANGEMENTS: SERVICE DELIVERY

Different approaches to private airport investment in the United States illustrate the variability in the amount of the private investment and degree of governmental control. It is therefore useful to distinguish between P3 arrangements that are primarily designed to provide services or management for airport operations and those that are designed to deliver, operate and maintain a capital project. This section outlines the permutations of P3 arrangements that are used for delivery of services for an airport.

- *Service Contracts* – Contracting for non-core services, such as cleaning, elevator and electric walkway maintenance, shuttle bus operations, financial consulting and engineering and design services are routine at airports in the United States. This option requires little or no private capital investment and would not typically be referred to as a P3 absent an unusually broad scope or other customizations.
- *Management Contracts* – This option provides a vehicle for private management of existing airport facilities ranging from parking facilities to an entire airport system. Like the previous option, this approach is common in the United States with many permutations in the level of management control and extent to which operations are the responsibility of the management firm. In the U.S., airport proprietors generally at least retain contractual control over key decisions such as compliance with use and lease agreements, planning, environmental policy, and debt policy and capital expenditures. Where the project to be managed was funded with governmental bonds, there may be tax requirements that must be considered when negotiating the management agreement as well. This option may be appropriate once an airport is built, or may grow from a design, build and finance structure. It is not likely to meet a local government's need for capital investment.

- *Airline or User Consortia* – Airlines and other users increasingly perceive that they can save costs and increase operational control over airport assets by offering to enter into consortia to operate key airport assets. The most common are fuel supply or delivery consortia, in which the consortium may just operate the fuel system or may construct and finance the system as well. Consortia are also used for other facilities such as baggage claim, jet bridges, underwing services and other airport functions that exclusively serve one class of users (e.g., airlines). The degree of control over management, operations and capital investment can vary considerably.

III. TYPES OF P3 ARRANGEMENTS: PROJECT DELIVERY

The delivery of capital projects (e.g., a terminal, parking garage, etc.) is getting increased attention at airports. There are considerable variations in how a P3 could be employed in project delivery. The term P3[3] encompasses an array of project delivery arrangements, some of which are traditional in the airport sector, as well as several that are new (at least in the United States). The following are the main categories, many of which are likely already familiar to airport management[4]:

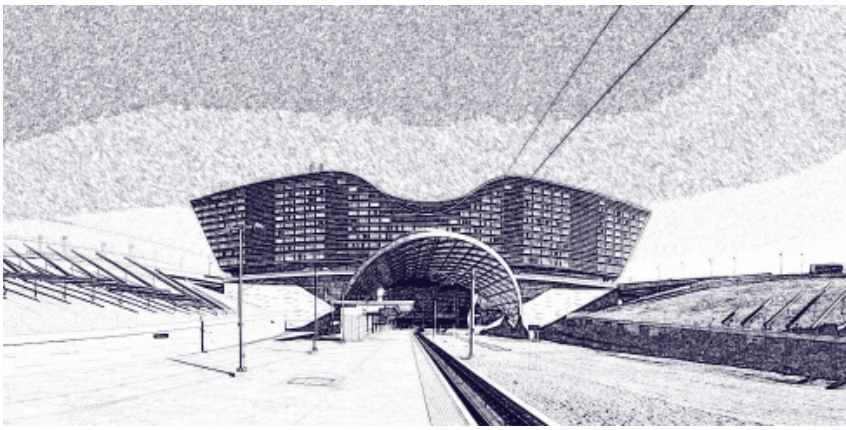
- *Full Privatization, Long-Term Lease, or Sale* – Under this model, the airport proprietor enters into a long-term concession and lease, or (less often) sale of an airport. This can be accomplished either through the FAA's Airport Pilot Privatization Program (APPP) or outside that program if the requisite legal constraints are addressed. Airports' experience with the APPP suggests that it is not a particularly useful model for most airports. While there are four airports participating in the program today (San Juan, PR; Westchester County, NY; St. Louis Lambert, MO; and Hendry County, FL), only two (San Juan and Stewart Airport in Newburgh, NY) have been formally approved, while the other airports' applications are pending, and a greater number of airports have been considered and rejected, or withdrawn from, the program.[5] By comparison, in 2016 there were 28 "majority private" (largely P3) and 79 "fully private" airports in Europe.[6] In addition to being cumbersome to use, the APPP has not proven to be effective or workable in the U.S. investment marketplace. Many sponsors also find the approach untenable because it would deprive the local government of the ability to maintain control over airport assets.

P3 as a vehicle for delivering airport projects is increasingly being considered to be an element of best practices in capital planning for airports – both large and small.

- *Private Airport Development* – There has been much discussion in the trade press and in academic circles about privately-funded airports, built and operated without federal assistance (i.e. without AIP grants). Branson Airport (Missouri) is currently the only privately-owned and developed commercial passenger airport in the United States. Branson has had enormous difficulty with its financing, has defaulted several times on its indebtedness, and is not generally seen as a viable precedent. One variation on this model that has rarely been used in the United States is the private development of an airport which is then sold or leased to a public entity. Fort Worth Alliance Airport, in Texas, is the closest example in the U.S. Alliance Airport is a cargo- and general aviation-only airport. It was a P3 venture, built mainly with public funds (on privately owned land donated to the City of Fort Worth). The motivating private sector goal was the development of the 14,000 acres on and around the airport that was owned by the developer. This approach is particularly useful for sponsors considering greenfield sites with considerable developable land either adjacent or nearby where there is sufficient demand for such development.
- *Design-Bid-Build (DBB)* – This contracting structure is perhaps the most traditional, (so much so that many in the P3 industry do not consider it to be a P3 structure). Under a DBB, the public entity engages an architect and/or a design engineering firm. A hard bid for contractors is solicited only after completion of the final design. The public entity retains responsibility for financing and operating/maintaining the project.
- *Design-Build (DB)* – This structure combines design and construction in one contract, usually based on a 30 percent design, and imposes responsibility and liability on one entity (usually the contractor or a special purpose/joint venture entity between the designer and contractor). It is typical for a DB contract to be a fixed-fee arrangement. Generally, the public entity is responsible for financing, operating and maintaining the project. There is a relatively new variation on DB known as Progressive Design-Build (PDB) in which the PDB team is selected, usually based on qualifications alone, much earlier in the design process. After

the design is further progressed (often between 50 percent and 75 percent complete), the design-builder will provide the owner a guaranteed maximum price for the project. Owners should be aware that while early involvement of the design-builder can lead to efficiencies, and an active owner working collaboratively with the design-builder can identify and mitigate costly risks early in the design phase, the negotiated nature of the contract price may lead to a higher cost of construction than a true competitive bid DB procurement.

- *Design-Build-Finance (DBF)* – Under a DBF, the procurement, design, construction, and financing (complete or partial) are combined into one contract. The public entity retains responsibility for the operation and maintenance. Under this model, the design-builder assumes responsibility for most of the design work (usually beyond 30 percent design, as with a typical DB procurement), construction and full or partial financing of the project. Financing under a DBF can take many forms, and DBF has been used to mitigate cash flow concerns with short-term financing, later "taken out" by the public entity retaining long-term operations and maintenance responsibility. Alternatively, financing can include traditional, long-term financing by the private entity. The inclusion of private financing can also result in the contribution of private equity capital to the project structure and a more complete risk transfer.



Denver International Airport Train Terminal

- *Design-Build-Operate-Maintain (DBOM)* – The DBOM model combines design and construction with long-term operation and maintenance into one contract, resulting in all of those functions becoming the responsibility of the contractor. The public entity assumes the financing responsibility for the project, while retaining the project revenue risk and any upside from project revenue.
- *Design-Build-Finance-Operate-Maintain (DBFOM)* – This model is perhaps the one most commonly identified with transportation P3s in the U.S. Under a DBFOM, the developer or concessionaire is responsible for designing, constructing, financing, operating, and maintaining the project. The Automated People Mover and Consolidated Rental Car Facility projects at LAX both follow this model, with the former project having recently achieved financial close following execution of a contract, and the latter expected to be awarded in 2018. The typical length of a DBFOM contract is the period of construction plus 30-35 years, but it is important to recognize that there is not a single approach and the DBFOM model is evolving in the airport context. Generally speaking, the public entity retains full ownership of the project, but that, too, can be subject to some permutations. Financing is repaid either by project revenues going to the developer or by availability payments[7] made by the public entity to the developer starting at project completion. Availability payments are often a useful tool to align the interest of the developer in receiving payment with those of the public entity in the facility being operated over the long-term in accordance with specified standards. Either financing approach can also include milestone payments to the developer or other earlier/fixed payments as funding permits, which reduce the amount required to be financed by the private developer, and thus, the overall cost of the project. To enable the private financing, the developer also invests private equity capital (typically 10-30 percent) that is repaid over the term of the project. Basic examples include a toll road, with toll revenue going to the developer, an airport terminal with revenues going to the developer along with some guaranteed availability payments, and a transit line with only availability payments. Financing techniques can, where permitted, include federal programs such as TIFIA and PABs[8], in addition to grants used to supplement or repay the private financing.
- *DBFOM with a Pre-Development Agreement (PDA)* – This model, becoming more common in U.S. P3s, combines a typical DBFOM structure with the early selection of a developer, similar to the Progressive Design-Build model. A typical DBFOM procurement requires a project scope that is sufficiently developed to solicit proposals that fully allocate design, construction, operation, and maintenance responsibility over the full project term in order to enable the developer to bid a comprehensive plan of finance for the full

project at a fixed price. For various reasons, owners, however, may desire to pursue a DBFOM, but also need to engage a developer team at an earlier stage of project design and development. In that instance, a PDA approach provides real benefits. Under the PDA approach, a competitively selected bidder takes the initial risk of developing a project, and, in exchange, receives a right-of-refusal to enter into the DBFOM contract on a negotiated basis once the project is deemed feasible. This arrangement is beneficial during the early stages of a P3 project when the scope and costs have not been completely defined. Private bidders will often propose an array of innovative development plans, and the owner, while retaining termination rights, selects the most feasible plan. The private entity is often reimbursed for—or often shares—its project development and bid preparation costs.

Lawyers need to be comfortable with the lack of clear precedents.

***Almost every deal today is* sui generis.**

Sophisticated investors' counsel is far more likely to be familiar with the range of P3 options than most public agency lawyers.

- *Operate-Maintain / Concession and Lease* – The above models address initial project delivery. In addition, there are forms of long-term operations and maintenance or concession and lease arrangements that can qualify as P3s. At the most extreme, these would extend to the entire airport (as is the case for many European airports, but is not generally possible in the United States except through the FAA's Airport Privatization Pilot Program). However, such arrangements can be downscaled below the level of a whole airport but still cover complex and high value airport operations. The purpose of using such arrangements would be to achieve some of the benefits of a P3 with respect to the delivery of a service or the operations and maintenance of a particular facility. In essence, this P3 is itself a permutation of the traditional maintenance or capital investment models.
- *Development Rights in Exchange for Infrastructure Investment* – This tool is relatively new in the airport industry but involves an exchange with a private sector investor in which the investor builds crucial infrastructure facilities that may not themselves be revenue-producing (e.g., runways or airfield facilities) in exchange for the ability to develop vacant airport real estate and retain revenue and profits from any development on the site. This approach gives the airport sponsor access to considerable capital without having to forfeit control over the capital facility itself. At airports with considerable vacant developable land, this arrangement can produce a win-win for the sponsor: investment in new infrastructure and new commercial or industrial development can enhance the economic value of the airport in the community.

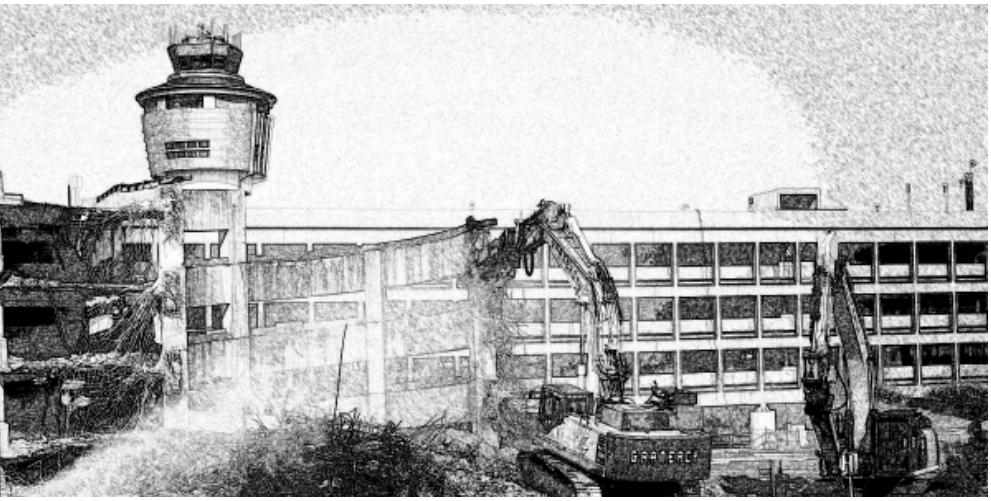
IV. SELECTING THE BEST P3 APPROACH

The rigorous evaluation of projects, including those that are the subject of unsolicited proposals, is essential to determine if a P3 structure is appropriate. The analysis of whether a P3 approach is appropriate starts with the very basic analysis of what the public entity is trying to accomplish. Among the questions that sponsor management should ask are the following:

- Is the public agency implementing elements of a master plan?
- Is the project focused on a revenue generating opportunity such as a parking garage or a consolidated car rental facility?
- Is the sponsor considering an unsolicited proposal for a new facility or project that is optional but could enhance the attractiveness of the airport or provide an additional revenue stream (e.g., airport hotel or solar farm)?

Full private development and operation of airports is not a particularly attractive option in the U.S. Instead, airports should look at specific airport functions or facilities when evaluating P3 opportunities.

There is not one single evaluation process that public agencies should use for deciding whether to pursue a P3 opportunity. Evaluation processes range from Virginia's Office of Public-Private Partnerships[9] annual project pipeline review and Pennsylvania's Board review of projects on an individual basis[10] to the Los Angeles County Metropolitan Transportation Authority (LA Metro) Office of Extraordinary Innovation's efforts to foster significant unsolicited proposals.[11]



LaGuardia International Airport

For some airport sponsors, a less formal and institutionalized process is likely to be more appropriate, but the fundamental premise should remain the same – it is critical for airport management to have a clear and robust internal process to review prospective projects in detail on a multi-disciplinary basis and for that evaluation to proceed independent of any specific proposal. Such process should typically be conducted in consultation with capable external advisors, particularly those with relevant financial, legal and technical expertise.

After initial screening, an effective evaluation process considers issues such as desirability, technical feasibility and financial feasibility. There may be more formal steps which may be appropriate, such as a value-for-money (VfM) study, also referred to as the P3 "business case" by some P3 sponsors. A VfM study typically compares a traditional public sector approach (the "public sector comparator") with a "shadow bid" for delivery of the same project as a P3, taking into account differences in construction costs (including lifecycle efficiencies under the P3), delivery schedule, public versus private financing costs, and project risk allocation.

In the end, any good evaluation process must leave considerable room for old-fashioned hard questions and experienced common sense knowledge.

V. FINANCIAL CONSIDERATIONS

A P3 structure does not produce free money. A P3 structure can, however, allow for financial innovation and structuring that increases the value achieved when deploying limited funds.

Regardless of what structure is selected, the airport proprietor must have a way to pay for, or let the P3 developer earn, its investment and a return on its capital and risk.

The developer/concessionaire will want to be repaid its equity investment, be able to repay (and demonstrate to lenders its ability to repay) any loans, and earn a reasonable rate of return. There are typically three primary payment models for P3s:

- *Project revenues*, such as user fees, utility fees, parking revenue, rental fees, concession revenues, advertising or other business revenue and lease revenue;
- *Availability payments* are payments made by the public entity or project sponsor to the concessionaire or developer in exchange for the delivery of the project and the performance of an ongoing service (e.g., operations and maintenance). These can be funded from various public sources, including project revenues; non-project revenues such as taxes; or for an airport such as landing fees, concession revenues, grant funds, PFCs, and non-aeronautical lease payments. Availability payments are typically made once a facility is in operation and depend on the developer achieving stated operational and reliability standards. These payments can be paired with progress or milestone payments paid during construction that cover part (but not all) of the construction cost; or
- *Management fees*, which are paid on a fee-for-service basis, a time-and-materials, fixed-fee or any of the other traditional bases for paying purely for services rendered.

The current Administration has committed to a massive increase in infrastructure spending.

Traditional federal funding sources will not provide most of this additional capital so private capital will be essential to achieve the Administration's goals.

Regardless of the exact payment model, any P3 that involves the investment of private equity and debt will need to have a payment structure that is creditworthy and bankable as determined by private investors and lenders. This requires an analysis of the public entity's legal authority to enter into the necessary agreements, and often also includes an analysis of the creditworthiness of the public funding sources underlying payment commitments to the private developer.

VI. ILLUSTRATIONS OF P3 MODELS

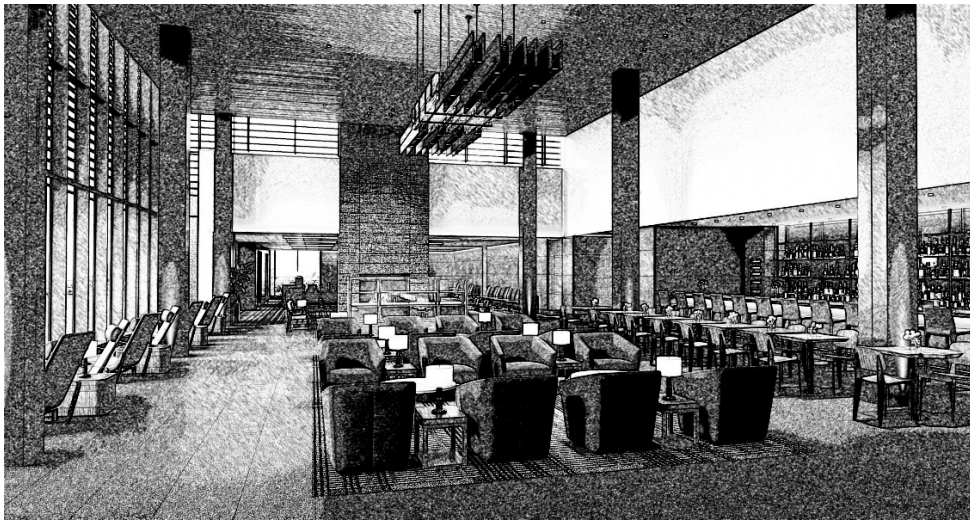
Los Angeles. Los Angeles World Airports (LAWA) has procured two major P3 projects, the $4.9 billion Automated People Mover (APM) system and the $1 billion Consolidated Rental Car Center (ConRAC), as part of a larger capital improvement program. The APM project is being undertaken by a consortium team including ACS Infrastructure Development, Dragados, Hochtief, Flatiron, Fluor, Balfour Beatty, and Bombardier. The ConRAC project has yet to be awarded. Both projects use an availability payment model, adapted to the different project facility needs.

While considerable industry attention has focused on mega projects, smaller P3 projects also offer enormous opportunities for creative investors and motivated airport sponsors.

New York. In the airport context, the new $4 billion Delta Terminal D (and C) at LaGuardia is being financed and constructed by a joint venture of Goldman Sachs and Delta Airlines, with a $600 million contribution by the Port Authority of New York and New Jersey. This follows the Central Terminal B $4 billion P3 project already underway at LaGuardia, which is being undertaken by a consortium team including Vantage, Meridiam, and Skanska.

Houston. Houston Airport System's version of a P3 was one in which Southwest Airlines funded and constructed a five-gate international terminal at Houston-Hobby. The challenge presented by the project was that Southwest needed an international terminal and accompanying facilities on a timetable that the Houston Airport System might not practically have been able to meet. Southwest assumed responsibility for construction and is being repaid from rental revenue from itself, other tenants and concessionaires. Houston pursued this approach for a number of financial as well as political reasons, the most important of which was the strong desire to keep Southwest happy and to complete the project on an aggressive schedule acceptable to Southwest. By shifting the construction burden to Southwest, Houston was able to shift any political risk for project overruns or delays to Southwest. The project was completed on time in 2015; at opening, Southwest was the only international carrier using the facility.

Chicago. The City of Chicago initiated a unique procurement process to invite private partners to propose an express airport connector service linking the Loop (central business district) with O'Hare International Airport. The project is being developed without public subsidy, thereby leaving revenue risk entirely with the selected developer. The City provided bidders with extensive flexibility as to terms, routing, and technology. At the conclusion of the bidding process, the City selected the Boring Company, who proposed an entirely below-ground system to be built using proprietary tunneling technology and to be operated using "skates" based on Tesla vehicles. The City and the Boring Company are currently negotiating the terms of a definitive agreement.



Rendering of Future Paine Field Terminal
Photo Courtesy: Propeller Airports

Seattle. An innovative example is Paine Field, near Seattle, the home to Boeing's widebody manufacturing facilities. Snohomish County, the airport sponsor of Paine Field, was confronted with an unusual political conflict when two airlines indicated a desire to begin commercial passenger service at the airport for the first time. Accommodating the airlines was a political minefield, but legally, the airport sponsor could not reject the request. In order to maintain an arms-length relationship with the accommodation of passenger service, the sponsor entered into a P3 agreement for the construction of a new terminal to accommodate scheduled passenger service. The approach is essentially a DBFOM approach in which the developer is assuming all of the construction and financing risks, but the developer also retains most of the operating profit (there is only a *de minimis* profit sharing with the airport sponsor). To package this arrangement, Snohomish County entered into a traditional ground lease, with the developer assuming both the risk and reward from new passenger service. The private sector developer is responsible for all contractual relationships with carriers and suppliers at the terminal. The terminal will open late in 2018 with 24 daily flights from three carriers. All available space in the terminal will be allocated before the terminal opens.

Austin. The City of Austin entered into a long-term agreement with a private entity to design, build, finance, operate, and maintain an existing airport building as an ultra-low cost carrier terminal facility. Austin–Bergstrom International Airport (AUS) was experiencing substantial growth and had difficulty accommodating all of the carriers that sought to serve the airport. This solution partially alleviated the necessity for several new gates while providing the ULCCs operating at AUS with a facility consistent with their business model.

Denver. Denver's $1.8 billion Jeppesen Terminal redevelopment project (known as the Great Hall Project) is intended to expand the capacity and improve the user experience of the airport's main passenger terminal. The project was procured using a PDA procurement methodology. The City of Denver did not prescribe a particular design or approach during the bid process, but instead invited the preferred bidder to enter into pre-development negotiations during which the terms of the final agreement were negotiated. The private partner consortium includes Ferrovial Airports, Magic Johnson Enterprises/Loop Capital, and Saunders Concessions.

Non-Airport Projects. Sometimes P3 projects are driven by financing issues, such as cash flow, as was the case with the Denver Regional Transportation District (RTD)'s EAGLE P3 rail line to Denver International Airport. RTD had sufficient revenue from its sales tax levy but could not make revenue available in the timeframe necessary to build the project on its schedule. RTD also did not have sufficient remaining debt capacity to issue its own debt. Other imperatives also made a P3 approach attractive, including the desire to shift long-term operations and maintenance to the private sector. In that project, the concessionaire is repaid through availability payments.

A different example in the highway context is Denver's Central 70 Project, currently being undertaken by the Colorado Department of Transportation (CDOT), the Colorado High Performance Transportation Enterprise (HPTE), and the Colorado Bridge Enterprise. The primary motivations behind CDOT's decision pursue a P3 were to shift price, schedule, and certain other construction-related risks on this highly-complex construction project to the developer, and to achieve cost certainty for the long-term operations and maintenance of the project. This decision was based on a comprehensive VfM study. Payments to the developer are through a series of milestone and availability payments. The relatively limited toll revenue expected to be generated from the new managed lanes will be retained by HPTE and used toward payments made to the developer for operations and maintenance of the project.

VII. LIABILITIES AND RISK ASSESSMENT

Liability. Even though in most P3 projects, the public entity shifts the construction and project delivery risk, as well as long-term operations and maintenance obligations, to the private developer, there are still inherent risks for the public sector.

P3 projects tend to be long-term endeavors with various liability issues arising at different stages of the contract. Two particular areas are often identified as the primary financial risks within the contract[12] :

- The direct payments to the developer/concessionaire such as availability payments or milestone payments; and
- Contingent liabilities, such as payments for termination events or relief/compensation events, which may reflect risk allocation between the public entity and the developer.

Understanding, negotiating, and being prepared to address these liabilities in a P3 agreement are critical for public entities. Appropriate project management plays a significant role in ensuring that these liabilities are properly managed. Otherwise, change order or relief/compensation event mechanisms can be abused, or performance and compliance regimes can fail to have their intended effect. Identifying these contingent liabilities and planning for them will help the public entity evaluate the merits of a P3 structure.

Risk Allocation. Project risk allocation is another factor often cited by public entities as a reason for pursuing a P3 structure. Risks such as construction and project delivery, environmental contamination, and compliance with FAA regulatory requirements can be transferred – but only up to a point, and only effectively where future contract administration considerations are paired with a detailed understanding of the project's unique challenges (beyond what precedent might suggest in terms of risk allocation). Developers often resist accepting certain risks (especially environmental risks) without considerable economic compensation. A public entity needs to be rigorous in evaluating what risks it wants to allocate and why, and in assessing the economic impact of shifting risks to the developer. In addition, developers are likely to price the perceived quality of the public entity's expected oversight of the project into the transaction. Those public entities with a robust project management capability often find that costs are substantially lower than for those agencies who are unprepared to comprehensively oversee a complex project. Such preparations can help the public entity in successfully deriving the best value possible from its decisions with respect to transferring risk.

VIII. REGULATORY CONSIDERATIONS FOR AIRPORT P3s

For airport projects, one unique complexity is the need to maintain compliance with the FAA Grant Assurances and the related FAA regulatory requirements. Not only are the Grant Assurances not drafted with any sensitivity to P3 imperatives but the FAA's general unfamiliarity with many P3 approaches means that navigating these requirements requires awareness, creativity and time. It is their unfamiliarity with the unique FAA regulatory structure that makes some European investors uncomfortable with the U.S. market.

While foreign investment often drives airport P3s, foreign investors and their lawyers often find the U.S. regulatory environment to be unfamiliar and confusing when compared to regulations elsewhere in the world.

Airport P3 projects are subject to regulatory considerations that are often absent in other P3 efforts, even in the transportation sector. There are several overarching regulatory impediments that have made sponsors—and some investors—reluctant even to consider P3 opportunities:

- *Revenue Use*. Under federal law, most airports must operate as a closed fiscal system, meaning that all revenue generated at the airport (or on airport-owned real estate) must be used only for the capital and operating costs of the airport. Other infrastructure P3s do not generally have this constraint, which means that models applicable to roads, rail or utility infrastructure may not necessarily be directly transferrable to the airport environment.
- *Regulatory Comfort*. The FAA is relatively unfamiliar with many P3 arrangements, even ones that are common in other arenas. Agency staff has limited expertise in navigating the regulatory hurdles for various P3 arrangements. As a result, the agency has provided relatively little guidance and direction to airport proprietors on what is, and is not, permissible in the highly regulated airport industry. While the FAA continues, at Congress' direction, to officially to support its Airport Privatization Pilot Program, it has been less enthusiastic to provide broad based guidance on how to structure P3 transactions. The guidance that does exist is generally highly fact-specific to a particular airport.
- *Grant Assurances*. Airport sponsors who accept federal grant funds (which include virtually all commercial service airports and thousands of general aviation airports listed in the FAA's National Program for Integrated Airport Systems), are subject to a complex web of obligations that attach to the receipt of grant funds. These obligations, known as grant assurances, generally carry a 20-year duration from the date of the last FAA grant, although some are perpetual. Accompanying the grant assurances is a complicated set of contractual provisions that the FAA requires be included in any airport sponsor contract with private sector entity.[13] The sheer number and breadth of these contractual provisions could significantly discourage private investment unless or until the FAA provides greater clarity on the extent to which the grant assurances apply to private sector partners in a P3 arrangement.

- *Mandatory Contract Language*. FAA requires that an airport sponsor's contracts contain both a subordination clause, (subordinating the relationship to any current or future FAA contractual or regulatory requirements) and a long list of contract clauses. These clauses address issues such as civil rights, labor relations, contracting with disadvantaged business enterprises, and other topics which are not necessarily common in the private sector or in the airport sector in other countries. The FAA has yet to provide any guidance on the extent to which these requirements apply to P3 arrangement or, more generally, to private sector contractors who have no contractual privity with the FAA.
- *Authority to Enter into P3 Contracts*. Each state's laws are different in their authorization for public agencies to contract with private sector entities to deliver services. Procedural predicates, limitations on the length of leases (or prohibitions on sale of public assets), and other contracting restrictions vary state-to-state and even within a state. Both legal and practical requirements with respect to use of union contracts may also affect the viability of P3 arrangements.
- *Airlines and Other Users*. Airlines and other airport users have historically been skeptical of P3 arrangements because of the fear that they will result in higher rates and charges, could lead to diversion of revenue from the airport and, perhaps most importantly, could reduce the political and practical control that users traditionally have over airport decision making. As more of these arrangements prove successful, this skepticism is likely to dissipate.

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Annotated Bibliography of Selected Reference Materials

The Transportation Research Board Airport Cooperative Research Program (ACRP) published a comprehensive guide to airport privatization in 2012 which has become the authoritative handbook for airport privatization efforts:

- *Airport Cooperative Research Program (ACRP) Report 66: Considering and Evaluating Airport Privatization*, Transportation Research Board (2012), http://www.trb.org/Publications/Blurbs/167156.aspx.

The U.S. Department of Transportation has published a number of useful guides and reports on P3s for transportation infrastructure:

- *Successful Practices for P3s: A Review of What Works When Delivering Transportation via Public-Private Partnerships*, U.S. Department of Transportation (2016), https://www.transportation.gov/sites/dot.gov/files/docs/P3_Successful_Practices_Final_BAH.PDF.
- *Guidebook for Risk Assessment in Public Private Partnerships*, U.S. Department of Transportation (2013), https://www.fhwa.dot.gov/ipd/pdfs/p3/p3_guidebook_risk_assessment_030314.pdf.
- *Risk Assessment for Public-Private Partnerships: A Primer*, U.S. Department of Transportation (2012), https://www.fhwa.dot.gov/ipd/pdfs/p3/p3_risk_assessment_primer_122612.pdf.
- *Value for Money Assessment for Public-Private Partnerships: A Primer*, U.S. Department of Transportation (2012), https://www.fhwa.dot.gov/ipd/pdfs/p3/p3_value_for_money_primer_122612.pdf.

The Congressional Research Service has published a guide for Congress on airport privatization options for its consideration:

- Rachel Y. Tang, *Airport Privatization: Issues and Options for Congress*, Congressional Research Service Report (2016), https://fas.org/sgp/crs/misc/R43545.pdf.

On a global level, the World Bank maintains a reference guide and related information related to P3s:

- *Public Private Partnerships Reference Guide – Version 3.0*, PPP Knowledge Lab (2017), https://pppknowledgelab.org/guide/sections/83-what-is-the-ppp-reference.

Endnotes

[1] The World Bank notes, "[t]here is no standard, internationally-accepted definition" for P3 (also known as PPP) and, as a result, "[t]he term is used to describe a wide range of types of agreements between public and private sector entities". *See What Are Public-Private Partnerships?*, PPPIRC World Bank Group, http://ppp.worldbank.org/public-private-partnership/ (last visited June 24, 2018). For purposes of this paper, we use the term P3 to refer to "contractual agreements between a public agency and a private sector entity that allow for greater private sector participation in the delivery of transportation projects", as such definition emphasizes that such arrangements can come in different forms and are distinguished primarily because they differ relative (i.e. "greater" participation) to customary existing practice. *See Public-Private Partnerships (P3)*, submitted to Department of Transportation Federal Highway Administration, https://www.fhwa.dot.gov/ipd/fact_sheets/p3.aspx (last visited June 24, 2018). This approach is appropriate in the U.S. airport context given an existing baseline of private sector involvement in airport infrastructure delivery and management.

[2] *See infra* note 5.

[3] *See supra* note 1.

[4] The U.S. Department of Transportation's publication "Successful Practices for P3s," (March 2016), is a good reference document. It is important to recognize that, if an airport proprietor intends to seek AIP funding for a project, not all project delivery mechanisms are available and many that may satisfy federal requirements are not familiar to federal contracting officers. It may be necessary to educate local FAA officials if the airport were to pursue any of these alternatives. *See Successful Practices for P3s: A Review of What Works When Delivering Transportation via Public-Private Partnerships*, U.S. Department of Transportation (2016), https://www.transportation.gov/sites/dot.gov/files/docs/P3_Successful_Practices_Final_BAH.PDF (last visited June 24, 2018).

[5] The Airport Privatization Pilot Program was established by federal law in 1966. 49 U.S.C. § 47134 (2012). According to the FAA, the program is "designed to allow airports to generate access to sources of private capital for airport improvement and development." *See Fact Sheet – Airport Privatization Pilot Program*, Federal Aviation Administration (Dec. 20, 2017), https://www.faa.gov/news/fact_sheets/news_story.cfm?newsid=21614 (last visited June 24, 2018). *See also Airport Privatization Pilot Program*, Federal Aviation Administration, https://www.faa.gov/airports/airport_compliance/privatization/ (last visited June 24, 2018). Federal law limits the number of participating airports to 10, of which only one can be a large hub airport and at least one must be a general aviation airport. There are currently only four airports participating in the program: (1) a small general aviation airport in Hendry County, Florida; (2) Westchester County Airport; (3) St. Louis Lambert International Airport; and (4) Puerto Rico's San Juan Luís Muñoz Marín International Airport, of which only San Juan is formally approved. Eight other airports have considered or started participation in the program but have later dropped out. The principal advantage of participation in the program is that federal law waives certain prohibitions on revenue diversion as a mechanism to encourage private investment. Nevertheless, the rigidity of the program and of the procedural requirements has made the APPP unattractive to most airport proprietors and to investors.

[6] *See The Ownership of Europe's Airports*, Airports Council International (2016), http://newairportinsider.com/wp-content/uploads/2016/04/ACIEUROPEReportTheOwnershipofEuropesAirports2016.pdf (last visited June 24, 2018).

[7] Availability payments generally are contractually guaranteed payments the public entity makes to the private entity to pay for construction, cost of capital, and operation and maintenance, and usually involves projects with little revenue generation. The "availability" of the payment typically refers to the availability of the asset that has been the subject of the P3 and the stated operational standards that must be met in order to achieve all or a percentage of the payments. By contrast, for a revenue generation project, there are usually no availability payments and the private entity receives all or part of the upside profit from the project itself, such as a parking structure or terminal facility.

[8] U.S. DOT's Build America Bureau (BAB) administers both the Transportation Infrastructure Finance and Innovation Act (TIFIA) loans as well as the Private Activity Bond (PAB) program. *See About the Build America Bureau*, U.S. Department of Transportation, https://www.transportation.gov/buildamerica/about (last visited June 24, 2018).

[9] *See, e.g., Final 2016 Virginia P3 Project Pipeline*, Virginia Public-Private Partnerships (Jan. 4, 2016), http://www.p3virginia.org/wp-content/uploads/2016/02/Final-January-2016-P3-Project-Pipeline.pdf; Virginia Public-Private Partnerships, http://www.p3virginia.org/ (last visited June 24, 2018); *Draft Implementation Manual and Guidelines for the Public Private Transportation Act of 1995*, Virginia Public-Private Partnerships (Jan. 2016), http://www.p3virginia.org/wp-content/uploads/2016/01/PPTA-Implementation-Manual-01-04-2016-final-posted-to-website-before-Jan-CTB.pdf.

[10] *See Providing for Public Private Transportation Partnerships Implementation Manual & Guidelines*, The Commonwealth of Pennsylvania 16 (Sept. 29, 2014), https://www.dot.state.pa.us/public/Bureaus/press/P3/P3ImplementationManual&Guidelines.pdf (last visited June 24, 2018).

[11] Between February 2016 and June 2018, LA Metro received 108 unsolicited proposals for P3s. *See Partnerships and Unsolicited Proposals*, LA Metro Office of Extraordinary Innovation, https://www.metro.net/projects/oei/partnerships-ups/ (last visited June 24, 2018).

[12] *See supra* note 4, at 33.

[13] The FAA has published a comprehensive list of required contract language. *See Contract Provision Guidelines for Obligated Sponsors and Airport Improvement Program Projects*, FAA Airports (June 19, 2018), https://www.faa.gov/airports/aip/procurement/federal_contract_provisions/media/combined-federal-contract-provisions.pdf (last visited June 24, 2018). While this comprehensive list, has been useful, it has also left open a number of complex questions concerning the circumstances under which language must be included in contracts with no federal financial involvement or where the airport proprietor has no direct contractual privity. *Id.*

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