EVOLVING ISSUES: PUBLIC/PRIVATE TRANSACTIONS

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INTRODUCTION

"Public-private partnerships" or "P3" transactions are colloquial terms encompassing a broad range of cooperative activities between the public and private sectors. Over the last several decades, both the legal context in which public/private transactions are evaluated in Washington as well as the scope and complexity of those transactions have evolved.

First heralded nationally during the 1980's as a way of making the public sector more efficient, these activities included the privatization of traditional governmental functions such as the operation of prisons, sewage treatment plants and parking facilities through private contracting. More recently these transactions have involved the sale of public assets such as roads to private entities for tolling, both to realize management efficiencies and to provide working capital to cash-strapped public entities. Other transactions sometimes characterized as public-private partnerships involved the issuance by public entities of industrial revenue bonds and qualified 501(c)(3) bonds to provide tax exempt financing for privately owned projects in accordance with the Internal Revenue Code. Public investments intended to stimulate complementary private development have been designed to spur urban economic activity. In addition, public and private entities have constructed co-located facilities to achieve development economies, generate taxable economic activity and capture the possibilities of integrated urban design.

This growing intimacy between the private and public sectors to achieve a range of goals has required the application of existing law to new and sometimes novel situations and in some cases has required the reinterpretation of constitutional and statutory provisions. It has also raised a host of non-legal challenges as the respective cultures of the public and private sectors engage and sometimes clash.

CONSTITUTIONAL ISSUES

A. Gifts of Public Funds

In Washington, public/private partnerships have long been viewed with skepticism because of provisions in its late 19th century state constitution that prohibit the giving of public funds or lending of public credit except for the necessary support of the poor and the infirm. See WASH CONST. art. VIII, sections 5 and 7. These constitutional limitations were most narrowly construed in 1974 in *Port of Longview v. Taxpayers*, 84 Wn.2d 475, 527 P.2d 263 (1974), amended by 85 Wn.2d 216; 533 P.2d 128 (1975), where a unanimous Supreme Court ruled that even conduit financing by local entities for the sole purpose of qualifying bonds for tax exemption

under federal tax law—where no public moneys were used or put at risk—was constitutionally prohibited because it benefited private parties. See *Port of Longview*, 85 Wn.2d at 225; 527 P.2d at 268. By 1982, the citizens of Washington had changed the constitution to permit industrial development bonds, but in a series of cases beginning in 1978 the court began to reexamine its own interpretations of the Constitution. In *Johnson v. Johnson*, 96 Wn.2d 255, 264-66, 634 P.2d 877, 882 (1981), Justice Utter acknowledged the untenable position the Court had found itself in:

> Judicial approaches should be reexamined when the court creates several technical exceptions to preexisting holdings or when the holdings are differently applied for no significant reason. The presence of inconsistent analyses or exceptions suggests the approach may have outlived its relevance or was improvidently fashioned. Our checkered approach to section 5 problems mandates a reexamination of this area.
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> Examining this area of law can only lead to the conclusion that its evolution is contrary to the genesis of section 5. That provision, and ones similar to it, arose in the nineteenth century in response to reckless government subsidization of public and communication projects. . . . These private ventures were highly speculative and many failed, leaving government entities, and thus the taxpayer, either holding worthless stock or liable for large, inadequately secured debts.

Id. (internal citations omitted.) Reaching back to the historical roots of Article VIII, Sections 5 and 7, the Court fashioned a series of more pragmatic rules that protect against the evils of public subsidy witnessed in the nineteenth century, while establishing a foundation for public/private partnership in the twenty-first century. See Jay A. Reich, *Lending of Credit Reinterpreted: New Opportunities for Public and Private Sector Cooperation*, 19 Gonz. L. Rev. 639 (1983-1984); Hugh Spitzer, *An Analytical View of Recent "Lending of Credit" Decisions in Washington State*, 8 U. Puget Sound L. Rev. 195 (1985).

Article VIII, section 5 of the Washington State Constitution provides that "[t]he credit of the state shall not, in any manner be given or loaned to, or in aid of any individual, association, company or corporation." Despite differences in text, the Washington Supreme Court has consistently found that section 5 should be read the same as Article VIII, section 7, which applies to municipal corporations. Article VIII, section 7 states that "[n]o county, city, town or other municipal corporation shall . . . give any money or property, or loan its money, or credit to . . . any individual, association, company or corporation, except for the necessary support of the poor and infirm . . . ."

The Washington court has developed a two prong test to determine whether an expenditure of public funds constitutes a prohibited gift. Under the first prong of the gift analysis, the court determines whether the expenditure carries out a fundamental governmental purpose. If so, then there is no gift of public funds and no need for further inquiry since the carrying out of this fundamental governmental purpose inherently represents adequate consideration. *CLEAN v. State*, 130 Wn.2d 782, 797, 928 P.2d 1054 (1996). In *CLEAN*, the Washington Supreme Court held that construction of Safeco Field to be leased to a private baseball team served a public purpose, but not a "fundamental purpose" of state government. Under the second prong, if the expenditures do not support a fundamental purpose of government, "[t]he court then focuses on the consideration received by the public for the expenditure of public funds and the donative intent of the appropriating body in order to determine whether or not a gift has occurred." *CLEAN*, 130 Wn.2d at 797-98.

To determine whether a payment under these circumstances is made with donative intent, the court looks to whether the government will receive consideration in return. The court gives great deference to a determination by the legislative body of the government entity making the payment that the consideration is adequate. See *CLEAN*, 130 Wn.2d at 797-800; *City of Tacoma v. Taxpayers*, 108 Wn.2d 679, 701-05, 743 P.2d 793, 804-06 (1987); *Adams v. University of Washington*, 106 Wn.2d 312, 326-28, 722 P.2d 74, 81-82 (1986). This means that a court does not inquire into the adequacy of consideration "[u]nless there is proof of donative intent or a grossly inadequate return." *City of Tacoma*, 108 Wn.2d at 703. To allow such an inquiry without such proof of donative intent would "intrude[] upon [the public entity's] power to make its own legislative judgment." *Id*. at 703. Without proof of donative intent or a gross inadequacy of return, the Court "appl[ies] a legal sufficiency test, under which a bargained-for act or forbearance is considered sufficient consideration." *Id*.

This evolving legal principal has been extremely helpful to attorneys advising municipal corporations. Whenever a municipality seeks to transfer public funds to a private entity for a purpose that is neither for the necessary support of the poor and the infirm nor in furtherance of a fundamental governmental purpose, the municipality should be advised to make clear findings with supporting evidence that it values what it is getting in return for the expenditure. In *King County v. Taxpayers of King County*, 133 Wn.2d 584, 949 P.2d 1260 (1997), the Washington Supreme Court underscored the specific terms of the lease between the public facilities district and the Mariners that constituted adequate legal consideration. Chapter 36.100 RCW and the terms of the lease required:

- a commitment by the Mariners to play at least 90 percent of their home games at the stadium for the length of the term of the bonds issued to finance the stadium;
- a $45 million contribution by the Mariners towards costs of the project or associated facilities;
- profit-sharing with the public facilities district for the term of the bonds (for profits earned after accounting for team losses);
- payment of $700,000 in rent per year;
- payment of any construction cost overruns;
- a guarantee of debt service on the portion of the bonds issued to finance the stadium parking facility;
- maintenance and operation of the ballpark as a "first-class facility" in accordance with a management plan, with oversight by the district;
- making major repairs and capital improvements to the ballpark; and
- provision of insurance.

Reviewing these terms, the Court concluded that the lease "met the test of legal sufficiency."

If the municipality determines that it is receiving valuable consideration for its expenditure, then the fact that private parties are being incidentally benefited is not relevant to the constitutionality of the transaction. This is a central concept of public/private partnerships, because the private partner is unlikely to participate unless it benefits from the transaction. If such private benefit were ultimately determinative of whether the transaction is constitutional, few public/private partnerships could withstand constitutional challenge. The courts have determined that the critical question is whether the governmental body determines

that it received adequate value for its expenditure, not whether any private entities benefited either directly or indirectly. Except in an extreme situation, the court will defer to the pragmatic and political judgment of elected officials that the expenditure of public funds is a prudent investment.

B. Lending of Credit

The lending of credit prohibition is probably limited to the situation where a creditor of a private borrower would look to the state or a local public entity for a guarantee or other credit support with respect to the repayment of a debt. Note that the prohibition would not apply to the credit support of one public entity by another, for example, where a county might provide credit support to a public housing authority.

C. Conduit Financing

Conduit financing involves the use of a governmental entity to borrow on behalf of a private entity and thereby provide to the private entity the lower interest rates of tax-exempt financing. Because these transactions involve debt and credit, they may implicate the constitutional prohibition on the lending of public credit to private entities. The courts have held in a number of cases that a carefully designed conduit transaction is not constitutionally prohibited.

The analysis begins with transactions involving federal funds that are transferred to a municipal corporation for subsequent disbursal to private entities. For example, in the Model Cities Program of the 1970's municipalities acted as conduits for federal funds going to private anti-poverty contractors. The Attorney General determined that the constitutional prohibition against the gift of funds or the lending of public credit does not apply to the use of federal funds, and therefore if the federal support can be segregated from state and local public funds, there is no constitutional issue. See Op. Att'y Gen. No. 18, at 5 (1973); WASH. REV. CODE 35.21.730 to .757.

Conduit financings involving tax exempt bonds have been upheld by reference to the same principles. Typically, a private entity seeks financing for a private purpose that is recognized by the Internal Revenue Code as eligible for tax exempt financing. The Code requires that the funds be borrowed by a governmental entity and permits the borrowed funds to be loaned to the eligible private borrower. It is the private entity that must repay the loan to the lenders or bond investors. The municipality is involved in the transaction only because federal tax law requires it. There is no public money used or credit loaned because the government entity is not guaranteeing the debt of another. The exemption from taxation on the bond interest, the only benefit derived, is at the cost of the federal government. While the court struggled with this distinction in *Port of Longview*, 85 Wn.2d at 230-31, 527 P.2d at 270-71, it resolved the matter in subsequent cases. So long as the borrowed money and the repayments are segregated from the public treasury and the public issuer of bonds is not liable to repay the private debt, there is no constitutional prohibition of these transactions. Indeed, these conduit financings are so obviously distinguishable from the transactions that the framers of the Constitution sought to prohibit that the court ultimately had no difficulty in distinguishing and upholding them. See, e.g., *Washington Econ. Dev. Fin. Auth. v. Grimm*, 119 Wn.2d 738, 748-50, 837 P.2d 606, 611-12 (1992); *Washington State Hous. Fin. Comm'n v. O'Brien*, 100 Wn.2d 491, 498-500, 61 P.2d 247, 251-52 (1983); *Washington Health Care Facilities Auth. v. Spellman*, 96 Wn.2d 68, 74-76, 633 P.2d 866, 869-70 (1981); *Washington Health Care Facilities Auth. v. Ray*, 93 Wn.2d 108, 110-15, 605 P.2d 1260, 1261-64 (1980).

D. Partnerships

Municipal corporations rarely enter into partnerships due to concerns about constitutional limitations. While Article XII, Section 9 specifically prohibits public ownership of stocks, there is no explicit prohibition of partnership with a private entity. Nonetheless, because being a partner in a general partnership exposes each partner to joint and several liability, a municipal corporation could be held liable for the actions of its private partner. This could arguably be interpreted as a prohibited lending of the municipality's credit since the partner or entities contracting with the partnership could perceive the municipality as obligated, perhaps in an unlimited amount, with respect to a potential liability of a partner or the partnership. The courts have found that the framers of the constitution sought to minimize municipalities' "risk of loss" and to make certain that control over that risk is not in the hands of a private entity. While a public entity may take appropriate risks, it must maintain control of its financial exposure. See *Washington State Hous. Fin. Comm'n*, 100 Wn.2d at 498-500, 671 P.2d at 251-52; *Johnson v. Johnson*, 96 Wn.2d 255, 267-68, 634 P.2d 877 (1981) (plurality opinion); *State ex rel Washington Navigation Co. v. Pierce County*, 184 Wash. 414, 425, 51 P.2d407, 412 (1935).

Municipal corporations have entered into statutorily authorized contractual arrangements with attributes of a partnership where liability of the municipality has been limited and control over risk can be asserted. See, e.g., *Public Util. Dist. No. 1 v. Taxpayers*, 78 Wn.2d 724, 479 P.2d 61 (1971). Housing authorities have entered into limited partnership arrangements where the housing authority is the general partner and the limited partner cannot impose liability on it. This is done frequently in transactions involving the federal low income house tax credit, where the limited partner is a tax credit investor that contributes equity to the partnership controlled by the housing authority in return for the tax credit. See I.R.C. § 42 (West 1994 & Supp. 1998). Public development authorities have similarly entered into limited partnerships where they are the sole general partner or a limited partner to realize the benefits afforded by federal tax law.

E. Other Constitutional Provisions

At various times other constitutional provisions may be relevant to public/private transactions.

1. Art. VII, section1. This section prohibits the contracting away of taxing power. Agreements between a public entity with taxing authority and a private entity which purport to limit the authority of the public entity to tax the private entity may be prohibited. On the other hand, a valid exemption from of certain activities or a class of taxpayer from excise taxation that induces a taxpayer to invest in a project would not necessarily evidence a contracting away of the authority to tax. Furthermore, it would not run afoul of the gift of public funds prohibition since the exempted tax revenues never reach the public treasury so they could not be gifted or loaned. Certain taxes such as an admissions tax or parking tax on a facility can be characterized as "private payments" under the Internal Revenue Code and cause an otherwise public project to lose its tax exempt funding. The contractual promise not to impose such taxes on a particular project could implicate this constitutional prohibition. Recently the provision has been discussed in the context of an interlocal agreement creating a public facilities district pursuant to RCW 35.57.010, where the forming entities agreed to limit the authority of the district to put a voter tax proposition on the ballot without the agreement of each of those entities.
2. Art. VII, section 1; Art. VIII, section 6. These provisions require that public debt be incurred and taxes levied exclusively for public purposes. The scope of the prohibition is sometimes conflated with the prohibition on the gift of public funds. The provision requiring that expenditures be

made for public purposes goes to the ultimate purpose of the expenditure rather than simply prohibiting transfers where there is "donative intent." An expenditure made without "donative intent", i.e. not a gift, would still be prohibited if the consideration received was not in furtherance of a public purpose. See CLEAN v. State, 130 Wn.2d 782, 792-797, 928 P.2d 1054 (1996).

3. Art. VII, section 1. This provision provides for the uniform levy of property taxes and would prohibit the exemption of property from taxes when not clearly authorized by the constitution or the imposition of differential taxes on similar property within the jurisdiction of the taxing authority. It has also been held applicable in certain circumstances to excise taxes.
4. Art. VII, section. 9. This provision provides for the assessment of private property that is specially benefited by a public improvement. It can be used to provide for the tax exempt financing of public improvements that provide specific benefit to private property owners.
5. Art. XII, section 9. This provision prohibits public ownership of private stock, though it does not directly address how public private/partnerships can be structured.

Because the constitutional interpretations evolve and are applied to new deal structures and fact patterns, constitutional analysis remains an ongoing challenge.

STATUTORY ISSUES

A. General Authority

Even if a contemplated action by a municipal corporation could withstand constitutional challenge, it can only be undertaken if the municipal corporation is authorized to take such action. The law is not entirely clear on the inherent authority of various municipal corporations to act in the absence of explicit authority granted by the State. Many courts have stated the general rule that municipal corporations have implicit authority to do only what is necessary to accomplish what has been explicitly granted. See, e.g., *Granite Falls Library Capital Facility Area v. Taxpayers*, 134 Wn.2d 825, 834; 953 P.2d 1150, 1154 (1998). On the other hand, cities of the first class have all of the authority of the state that is not preempted or prohibited by the state or homerule charter. See *Chemical Bank v. Washington Pub. Power Supply Sys.*, 99 Wn.2d 772, 792-93, 666 P.2d 329, 340 (1983); *Winkenwerder v. City of Yakima*, 52 Wn.2d 617, 622, 328 P.2d 873, 877 (1958). As a municipal corporation, the first class city's authority is generally understood as being limited to those powers expressly granted, and to those essential to the declared objective and purposes of the city. Municipal attorneys generally take the position that public corporations created by a city or county pursuant to WASH. REV. CODE 35.21.730 to .757 have no more authority than the municipal corporation that created them.

B. Indebtedness

The state constitution as well as state statutes limit the amount of debt municipal corporations may incur with and without a public vote. See WASH. CONST. art. VIII, § 6; WASH. REV. CODE 39.36.010 to .900. If a transaction obligates the municipal corporation to make future payments of public funds, it is important to determine whether such an obligation constitutes a debt for purposes of calculating the municipality's debt limitation. Often this question will turn on the characterization of the transaction as either a true lease or a financing lease, or a contingent obligation. See WASH. REV. CODE 35.42.200. In a recently argued case, the Supreme Court was asked to clarify when a "contingent obligation" would count as indebtedness subject to constitutional and statutory limits. See *Bond Issuance of Wenatchee PFD v. City of Wenatchee*, S. Court No.

86552-3; *Comfort v. City of Tacoma*, 142 Wash. 249 (1927). Furthermore, obligations which will require the municipality to borrow funds in the future can only be fulfilled if that future borrowing is within the municipality's debt limitation at the time the obligation arises.

C. Public Bidding

If the public/private arrangement involves the construction of a building or utility infrastructure, it is important to determine whether the project is a "public work" as defined under WASH. REV. CODE 39.040.010 and subject to public bidding. Depending on a number of factors, it has been estimated that the public bidding of a contract can increase the price of such contract by as much as 25-30%. In many joint development projects therefore, significant cost advantages can be realized by the public entity if public bidding is not required. Said another way, from the private sector perspective, significant costs may be added to a project that is subject to public bidding due to public sector involvement.

WASH. REV. CODE 39.04.010 provides that "[t]he term public work shall include all work . . . executed at the cost of the state or of any municipality, or which is by law a lien or charge on any property therein." Id. (emphasis added). There is no case law interpreting the phrase "lien or charge on any property," but the Attorney General has construed it to cover cases where a contractor would have a lien against the property of a public body, but for the lien exemption enjoyed by public property. See Op. Att'y Gen. No. 2, at 4 (1983). Similarly, the courts have not interpreted the phrase "executed at the cost" of a public agency. The Attorney General has noted, however, that it would be contrary to the public policy of chapter 39.12 of the Revised Code to allow its requirements to be easily circumvented. See Op. Att'y Gen. No. 17 (1988) (stating that a lease-leaseback arrangement should not change a project's status as a public work); but see Op. Att'y Gen. No. 18 (1996) (exempting the Washington State Convention and Trade Center from competitive bidding requirements because of legislation that required incompatible actions); AAG Dias memorandum dated April 10, 1998 (deciding that a garage was not "executed at the cost" of the city because the city bore no risk during the project's construction or interim operation).

In determining whether a project is a public work, a court must interpret relevant factors including whether the land on which the project will be constructed is owned by a public or private entity, whether the public party has financial risk during construction, whether progress payments are being made by the public party, and the relative sizes of the public and private portions of a joint development project.

D. Prevailing Wages

It is also important to determine whether the project is subject to prevailing wage under WASH. REV. CODE 39.12. Any project that the state or municipality "causes to be performed by a private party through a contract to rent, lease, or purchase at least fifty percent of the project by one or more state agencies or municipalities" shall comply with the state's prevailing wage statute. WASH. REV. CODE 39.04.260. Depending on the wage scales applicable to a particular location, this provision can significantly affect the cost of a project. Where a public project is combined with a private sector project, the requirement to pay prevailing wages on part of the project may require a careful allocation of wages costs between project parts.

E. State and Local Taxes

There are a host of state and local tax issues that arise in public/private transactions that can have significant effects on the economics of the project. These include:

1. Property tax exemptions available to public projects but not private projects. See WASH. REV. CODE 84.36.010.
2. The leasehold excise tax which arises when a private entity leases public property. See WASH. REV. CODE 82.29A.030, .040.
3. Real estate excise taxes that are imposed when projects are purchased by private parties. See WASH. REV. CODE 82.46.030.
4. Specific tax exemptions such as the exemption available for property owned by a housing authority under WASH. REV. CODE 35.82.210.
5. Special excise tax exemptions for parking garages leased under WASH. REV. CODE 35.42.010, .090.

As in any private sector transaction, careful structuring of the project can reduce its cost.

F. Federal Tax Issues

Section 103 of the Internal Revenue Code of 1986, as amended, provides for the exemption from gross income of the interest on certain municipal bonds. Such tax-exempt financing during construction can significantly reduce the cost of construction and reduce the ongoing interest cost of debt. The tax exemption turns on a number of factors that are beyond the scope of this paper, but among the key factors are whether the project financed by the debt is used for a "public purpose" or a "private activity," and whether the debt is repaid from "public" or "private" sources. Again, how the transaction is structured can determine whether it is eligible for less expensive, tax-exempt financing.

TRANSACTIONAL ISSUES

While the range of public/private transactions remains broad and in many cases straightforward, a growing number of public/private transactions in recent years have become more complex, difficult to complete and problematic in terms of their results. There are at least three interrelated factors that have contributed to this trend: (a) public entities have encountered a continuous erosion of federal and state funding available for economic development as well as a decline in sales tax revenues, causing them to look more aggressively at private entities with which to partner and leverage resources; (b) the recent downturn in the economy has made it more difficult for private entities to realize both debt and equity financing causing them to be cautious in making commitments and less able to pull the trigger on deals; and (c) given these economic challenges the allocation of risk between parties has been more difficult to negotiate and resolve.

Public entities are under tremendous pressure to diversify and grow their tax base, and consequently partnering with private entities is viewed as an important strategy for financial health, if not survival. Popular initiatives limiting the growth of property taxes or the imposition of motor vehicle excise taxes combined with a general downturn in the economy and aversion to debt at the federal and state level have put enormous pressures on local governments. Cities that are dependent on property taxes have felt the strategic need to diversify their tax base by stimulating retail development, and those dependent on excise taxes have experienced significant reductions in revenue. Public/private partnerships to induce private development and thus stimulate the economic base subject to excise taxes have been seen as an important long term strategy. Given the political climate, it has become clear that simply waiting for state or federal stimulus funds is a doubtful strategy.

On the private side, it has been very difficult for developers to commit to investments given uncertainty in the debt and equity markets and the feared contraction of retail leasing. This may be a cyclical challenge or it may reflect a trend away from big box retailing or a consolidation of the retail, hotel and commercial marketplaces. Private sector developers understand the cycles of the market place and are disciplined by their need to borrow and seek investors; their public partners facing the lay-off of police and social service providers may not have the patience or the experience to see the trends.

Among the consequences of these financial and political forces are increasingly complex transactions. Some of the transactions involve multiple public agencies, e.g. a city, a housing authority and a public library as well as a private developer, all seeking to leverage their respective resources. The general goal is some sort of co-development or at least coordinated development to realize economies in terms of design, construction and land use while creating an interesting urban experience. While this is a worthy goal that is at least theoretically achievable, the actual benefit needs to be weighed against the cost and risk attendant to the complexity of such arrangement. As the parties begin to sort out their respective goals, available resources, timing and tolerance for compromise, it becomes more and more difficult to pull the "deal" together. As the potential upside of this joint development becomes public, however, it becomes more difficult for the public parties to walk away; and once that becomes apparent to the private party, bargaining leverage can shift.

Another consequence is the need to engage in sophisticated market analysis, financial projection and risk assessment for which the public parties may not be well suited or staffed. Almost all of these projects require projections of future economic performance based on assumptions with regard to when construction will be completed and when private rent-up will occur, as well as operating costs levels and the use of reserves for contingencies. In short, these are business deals, and the public entities are projecting future tax revenues available to pay debt service and operations just as the private developer is projecting cash flow and profit. Ultimately these projects require a risk assessment and risk tolerance by the public entity that is different from what would be encountered in a more traditional, stand-alone public construction project such as a library or city hall. The multiple uses and multiple parties – and in particular the presence of a private entrepreneur in the equation – changes the analysis and discipline required.

How to identify the risks associated with these projects and how to allocate those risks is a major challenge to the parties of a public/private partnership, especially to a public entity that may have had little experience in real estate development. As it approaches negotiations, the public entity needs to have clear goals in mind as well as clear understanding of whether those goals are consistent with the goals of its private partners. The public entity also needs to reach a threshold agreement with its partners before it expends enormous resources drafting documents and political capital raising expectations.

While each transaction is truly unique, here are a few suggestions that may help discipline the process and increase the likelihood of reaching an agreement with the opportunity for success. First, the public agency needs to carefully choose its private sector partner. Developers are often salespeople, so the public partner needs to delve into the relevant experience, financial wherewithal and motivation of the partner with whom trust (with verification) will be critical. It can be helpful to engage local citizens with a business background to advise the municipal entity and provide counsel and support during the negotiation process. Second, the public agency needs to define its goals and the limits of its investment going into negotiations. Public entities are vulnerable to romanticizing the potential of a project and falling in love with a vision that they cannot afford; their private partners tend to be more steely eyed in their analysis and often have the freedom to move to

another location if they do not get want they want from their public partner. Third, the public entities need to be every bit as analytical and market savvy as their private partner – both to understand the risks of the project but also the constraints on and needs of their partners. If the public entity does not have that sophistication within its staff, it should consider hiring consultants that can help provide such market driven insights. Fourth, these projects need leadership that will drive a schedule and identify critical milestones including moments at which the project will go forward or needs to be terminated. Time is usually not the friend of market transactions, and public entities need the discipline to be able to walk away or start with another partner.

CULTURAL ISSUES

Public/private partnerships, regardless of their form or economic advantage to the private or the public sector partners, merge two cultures with very different motives, measures of success, language, and expectations of privacy and public scrutiny. What may be understood as efficient and market driven from the perspective of the private sector may be perceived by critics as devoid of thoughtful public process, fraught with risk, and motivated by greed. To some extent these differing perspectives reflect a lack of understanding and imagination, perhaps by both cultures, but to some extent they reflect a real difference of values. Furthermore, these differences and these misperceptions become the fodder for the popular press. Often these projects are complex and difficult to understand upon a cursory review. The fact that the private sector partners to such a transaction are motivated primarily by profit should not be a surprise. There would be no private participation without the possibility of profit. Nonetheless, these projects are vulnerable to a kind of populist rhetoric and public scrutiny that is difficult for elected officials to withstand and private entrepreneurs to tolerate. This is not to suggest that such projects, if done carefully, are illegal or not worth the effort; it is only to suggest that the parties involved must understand that for both sides this may not be business as usual.

Public-private transactions generally require a close working relationship between the public and private entities involved in a transaction with reciprocal obligations of both parties. While the idea for a transaction may originate within either the public or private sector, a successful transaction requires the cooperation of both sectors. For example in a joint development context, before the public sector borrows and builds infrastructure, it will need confidence that the private investment will follow the public infrastructure if it relies on projected tax revenues to repay public debt. The private sector needs to have confidence that the public improvements will be built in a predictable manner with design and quality features appropriate to the private investment. This interdependence and financial intimacy—tested in the first instance during negotiation of a development agreement between the parties—often poses problematic cultural issues that need to be understood and addressed.

The public sector culture, while varying from jurisdiction to jurisdiction, is often characterized by slow, transparent public processes and political pressures. It is often infected with an aversion to financial risk and a general skepticism toward private enterprise. Public sector projects may be vulnerable to political attacks from those unwilling to spend taxes on projects that ultimately benefit private entrepreneurs. The private sector culture, while also varying from developer to developer, is often characterized both by swift and proprietary decision making and an unwillingness to commit to a project prior to receipt of debt and equity financing which turn on unpredictable market forces. The private project may go into default and the single asset entity may declare bankruptcy; its owners who often live elsewhere return home. In contrast, the elected and appointed public officials are left to justify their decisionmaking in public.

Projects dependent on projections of economic investment and activity can be complicated requiring a financial analysis for which small jurisdictions are often ill prepared. Local jurisdictions may have to retain high priced financial and legal consultants to effectively negotiate and ultimately partner with experienced developers, an expense which may add another level of skepticism about who is benefitting from the projects. Ultimately in order to succeed with public-private projects, cities or counties may need to leave their comfort zone of daily municipal work and even common infrastructure financings to engage in the competitive and unforgiving marketplace. They need not only the capacity to assess this risk but the discipline to walk away from inappropriately risky transactions. They cannot assume that the marketplace will treat them kindly if they promise to balance future budgets or increase future public services based on projected tax revenues.

These cultural issues, particularly with smaller and less sophisticated jurisdictions, necessitate thoughtful discussion within the public jurisdiction and the development of strategies to mitigate their risks. For example, a local jurisdiction needs to be very deliberate in selecting a partner that shares its goals and values. It would be wise for political leaders to consider local business advisory groups to help them understand the marketplace and provide political support for these projects. The local jurisdictions need the capacity to develop and understand financial spreadsheets and, to the maximum extent possible, share and confirm their financial assumptions with their private partners. Perhaps most importantly, local jurisdictions need to understand, internalize and be willing to defend the notion that only if their private partner stands to make material profits from the project will the private partner be willing to participate and make the investment that the jurisdiction expects.

CONCLUSION

Over the course of the last thirty or forty years many of the legal constraints once thought applicable to public/private partnerships have been clarified, if not eliminated, and no longer present the barriers once thought to prevent such transactions. At the same time, economic and political factors have made these transactions an increasingly important opportunity to leverage scarce resources. However, they require skills, flexibility, sophistication and a tolerance for risk- taking for which some public entities may not be equipped. It is an important road to travel if local jurisdictions hope to provide services and remain competitive in the market for future tax dollars. It is, however, a road for which public entities need to be well prepared.

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