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Public-Private Partnerships

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BUILDING LOCAL INFRASTRUCTURE BY LEVERAGING ECONOMIC DEVELOPMENT PROJECTS

As economic developers we are always looking for ways to maximize the benefit to our communities with each new economic opportunity. While we value the comfort of calculating the present value or simple net revenue expected from a potential increase in tax revenue, we should also be looking at the value of using these opportunities to create and improve infrastructure. While at the federal and state level there are sophisticated models and large-scale projects that attract a lot of private investment, mainly because there are opportunities for the private sector to realize profits, using incentives within an economic development project can be a great low-cost option used at the local level. This article demonstrates one approach using public-private partnerships as a way to build local infrastructure.

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Putting together a successful public-private partnership (P3) can be a challenge, especially at the local level. Generally, this may be because local officials have a perception of risk and (or) lack of control in addition to an inclination for not reinventing the wheel. As a result, they may lean toward what's worked before within the framework of usual funding options, like bonds, etc. They are usually not willing to go into uncharted waters (risk) to use private funding for public assets.

So, how do economic developers create a successful project and get elected officials interested in a P3 if they have no prior experience? You can usually win the day if you can show elected officials how private funds can be leveraged for a public benefit with minimal cost to the taxpayers. Successfully convincing our elected officials to use a P3 hinges on solid financial analysis.

P3s take a variety of forms and, generally speaking, any project that combines a private and public entity for the public good could be considered a P3. As an economic development tool, however, they are gaining momentum and should be considered as an option for infrastructure projects at the local level.

COMMON P3 STRUCTURES

P3s take a variety of forms and, generally speaking, any project that combines a private and public entity for the public good could be considered a P3. As an economic development tool, however, they are gaining momentum and should be considered as an option for infrastructure projects at the local level. And, for the sake of clarity for this article, an "economic development project" is one involving a private entity that is looking to locate or expand operations within your EDO's service area. This is where we will focus our discussion.

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FIGURE 1: COMMON P3 STRUCTURES

	P3 Structure	Private Responsibility / Risk	Public Responsibility / Risk
Higher Public Risk	Design-Build (DB)	Assumes financial risk for design and build at a fixed cost	Assumes responsibilities for financing, operating, and maintaining
	Design-Build-Finance (DBF)	Assumes financial risk for design, build, and full or partial finance	Long term operations and maintenance of the facility
	Design-Build-Operate-Maintain	Same as DB but now adds operations and maintenance	Financing through the public agency
Lower Public Risk	Design-Build-Finance-Operate-Maintain	Responsibilities for all five areas transferred to the private sector with some flexibility for financing	Generally financed through debt, repaid by project revenue, and supplemented by grants if needed

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Although P3s have been used at the national level within a formal structure for years, recently, with the renewed focus on rebuilding the country's critical infrastructure, they are also a viable tool to build local infrastructure leveraging economic development projects. This removes the legal cost of forming and ongoing costs of managing special taxing districts and bond interest expense. This is one benefit of using an economic development project as a P3.

To get a basic framework, let's examine P3 structures and the associated project risk and responsibilities in five common areas of an infrastructure project: design, build, finance, operate, and maintain. To get a comparison, Figure 1 shows some common frameworks suggested for state and federal infrastructure P3s. (https://www.transportation.gov/buildamerica/project-development/public-private-partnerships-p3/successful-practices-p3s-march-2016 (Accessed February 1, 2022)).

These frameworks are great to help understand how to identify general roles within a P3. However, local projects would likely fall within the first two structures because they are on a smaller scale and there is less opportunity for the private sector to recover cost and show a reasonable profit for their participation as they rarely have an operational component.

The key for economic developers is creating a reason for the private sector to participate. Usually this requires offering some type of tax incentive in order to leverage their capital for a project. This means that the public benefit is evaluated in the usual terms of increased tax revenue and jobs, but adds the value of the new public infrastructure and the reduced financial burden on the taxpayers for building that infrastructure. This is then compared to the value of local government incentives. This approach is not all that uncommon, but the financial analysis is really critical when incentives are involved.

By using P3s for infrastructure within the context of an economic development project, the benefits are more directly tied to the parties involved, each with their own needs and requirements. So, how do we encourage private investment when there is no revenue stream or profit associated with the new infrastructure like you may see at the state and federal level? In essence, the resulting infrastructure must have a direct benefit to the company (private entity). Why else would they be willing to risk their capital in your community when they may be able to find a suitable site elsewhere that doesn't require them to build infrastructure? Their "profit" is usually in the form of supporting their operation and (or) increased efficiencies. In the following project case study, it's reasonable to conclude that the degree of need (by the private entity) can be correlated to the level of their participation.

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On the private side there was one company, ROSS Stores, Inc. ROSS is a publicly traded Fortune 500 company with a market cap of around $41 billion (at the time of the project). The location being considered by ROSS was about 1.5 miles south of Interstate 10. There was only one, poorly maintained two-lane asphalt (county) road to the parcel and it needed to be widened and rebuilt to accommodate ROSS and create a safe road for the general public as well.

CASE PROJECT OVERVIEW

This project involved one governmental entity, Waller County, and one quasi-governmental entity, the Waller County Road Improvement District 1 (RID). Waller County is part of the Houston MSA and is adjacent to Harris County, the location of Houston. The current population is about 57,000. The estimated 2020 GDP was $2.9 billion according to the Federal Reserve Economic Data (https://fred.stlouisfed.org/release/tables?rid=397&eid=1067251#snid=1068433). Although still primarily rural, the county is in transition to becoming a suburban county.

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Additionally, the county mobility plan called for another road to run east/west to connect to the current road. The county needed to build or improve about 2.5 miles of four-lane divided road to support the site. ROSS would then be situated along both roads with the intersection forming the northwest corner of their facility. The new road significantly enhanced commuter safety for the public, operating efficiencies for ROSS, and opened up a larger area for future development. The latter can be tough to quantify but is certainly a direct benefit of the P3 with ROSS.

The new ROSS site is a 2 million-square-foot distribution facility sitting on about 180 acres within the RID. It is located in an economically disadvantaged census

FIGURE 2: RISK/RESPONSIBILITIES

	Design	Build	Finance	Operate	Maintain
Entity	Waller County/RID	Waller County/RID	ROSS	N/A	Waller County/RID
Roles	Local government engineering department working with engineers	Local government engineering department working with contractors	Up front costs covered by the business to be reimbursed after completion	N/A (in this case no real operators as it wasn't a revenue facility)	Local government responsible for ongoing maintenance
Risk	Minimal - mitigated through local control, some costs for right-of-way acquisition	Minimal - mitigated through local control and build standards	Assumed - mitigated by reimbursement agreement company pays up front for design and construction costs done by third-parties	N/A	Full - transfers to local government but mitigated through quality build standards and future tax revenue for maintenance

tract. This area has been a development priority for several years. Fortunately, it is a desirable area with a major interstate running through it.

The project followed the design-build-finance (DBF) P3 structure described earlier but with one slight modification. We needed to add maintenance which would be the responsibility of local government, not the private "operator." We now have a DBFM model. The risk is spread out according to expertise, not simply shifted away from the public sector as noted in the private operator P3 structures. Figure 2 shows how the risk/responsibilities were spread around for the five areas of the project.

This process boils down to a virtual if/then scenario within the normal negotiations for an economic development project. *If* the company needs a road, *then* would they help pay for it up front and in turn be reimbursed? Generally, this is done with bonds based on the taxable value added by the company. In this way it's like a TIF model without the added cost of forming and administering a potential improvement district.

Getting the financing up front is a very fast way to get things done. Companies should not only be reimbursed but also compensated for using their capital. To encourage this, the governmental entities need to be willing to use financial incentives. In this project, both governmental entities gave ROSS a "risk premium" by way of property tax incentives. Specifically, ROSS received a tax abatement that is estimated to save them $8.3 million over ten years. This helped compensate ROSS for using (risking) their capital to initially finance the road and also locate in our community.

THE PROCESS AT A GLANCE

Often a successful P3 begins when either the public or private entity has identified a need. The project should be in support of your community's economic development strategy. It should be considered within the parameters of your long-range strategic goals and be quantifiable. Following are some general steps to help guide you:

Step 1: Work closely to identify the needs of each stakeholder and determine the extent to which there may be synergies. This is key. The main reason to use a P3 is to gain synergies by leveraging private funding. Although this is a timing issue when in negotiations, sooner rather than later, put your cards on the table. Good businesses are happy to help because in addition to the financial benefits of incentives, there is also a social benefit.

Good companies want to get plugged into the community and be seen as a partner. Also, why waste time if it isn't going to work. We hear a lot about creating a "win-win" deal. That should be the goal of every negotiation. But few people ever talk about the last part of that concept, "win-win or no deal." It's better to walk away and maintain a relationship if you can't come to terms.

Step 2: Once you have identified what each party wants and needs to get out of the project, and determined there is enough synergy to move forward, then start working on the terms. This is when you get into the details and where projects can go off the rails. We know the proverbial devil is always in the details.

Use scenarios at this stage. This is a great way to take a real world (mental) look at the project. A lot of if/then discussions happen here. At this point undiscovered or unmentioned details surface. This is also an effective way to identify participation for committing resources to achieve the project goal.

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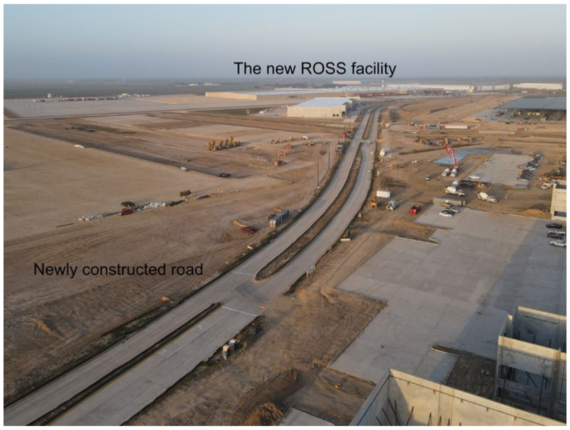

Far left: The new ROSS facility shown along the new road they helped to build. Also shown, additional development as a result of the new road.

Left: The new 2 million-square-foot ROSS distribution facility with additional new development in the area.

Finally, at this stage, take good notes and be willing to pause frequently to review while everyone is still in the room. Take your time here and meet as often as needed. Be sure to engage your elected leaders at this point to ensure political support.

Step 3: Evaluate these details identified in Step 2 in terms of cost/benefit of participation and their compatibility with your long-term goals. Because economic developers have the honor of representing our communities, this is the most important part of the process. It is critical to show taxpayers that our efforts result in good projects with quantifiable benefits. If it's a really good project, then this step should be easy.

Good fiscal impacts bring clarity to our roles as economic developers and show the community that our value goes way beyond that of a mere salesperson. And, amazingly, these inputs let us know if we can actually do the project. This should happen organically. The details are what they are. One of the most important qualities we should bring to the table is indifference. It's what allows us to be objective and credible in our analysis.

Step 4: Finalize the parameters of participation and roll them into a final agreement. Generally, this will be part of the incentive agreement if those are included with the company relocation/expansion, but it can be separated. They really are two different items that are just joined at the financial hip. Re-engage your elected officials at this stage to ensure there is still political support before going for a final approval. By this point things should be on auto pilot for the most part.

THE PROJECT IN DETAIL

This section describes how we used these general steps to get through the process. The steps are really not too different than any other economic development project. We are just adding private financing to fund a public asset needed for the project to succeed.

The background: We have the Waller County Road Improvement District 1 (RID) that had never done an incentive agreement and an existing road reimbursement deal in place between the county and the developers in the RID that needed to be removed to allow for a new "developer" to finance the remaining roads noted in the agreement.

A simple revenue calculation showed the RID the significant taxable value coming their way if they would just team with us to provide incentives. This was the fulcrum. The total incentive offer had to be significant enough to encourage ROSS to move to the area, participate in the P3, and help us remove the former road deal by getting the new road done. In the end, the RID came through and offered incentives worth up to $5 million. The county's part was about $3.3 million. Keep in mind, the RID tax rate was about twice that of the county's at the time. (See Tables 1 and 2)

The second task was to re-examine the old road reimbursement deal to see if the county would complete its obligation if ROSS were to build the remaining roads noted in the agreement. As it turns out, after legal review, it would. This then released the county from the balance of ~$2.4 million. This was a huge win as the road deal should have never been made since the roads covered in the agreement were in the RID.

Once we got through these first two items, the rest was much smoother sailing. ROSS and the RID finalized an agreement for the new road. ROSS would pay for the road up front and get reimbursed through RID bonds once completed. Because of the substantial taxable value added by ROSS, there will likely be no increase in RID taxes to pay for the bonds. The county would be responsible for obtaining the needed right of way (ROW) to expand the old existing road. The cost for the new

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ROW is about $600,000. This would have been much higher, but a majority of the ROW was donated by other property owners who realized the value it would bring to their property.

PROJECT BENEFITS

Now that you have a good understanding of the project, let's look at the financial benefits to all parties. From the preliminary information, there is a significant positive fiscal impact. By way of review, ROSS received a tax abatement from both entities valued at $8.3 million. In addition to financing the roads, they are adding 1,300 full-time jobs to the community at a wage rate above the regional average for similar jobs.

What is the benefit to each governmental entity? Each analysis is done over a ten-year period and uses the most conservative estimate of taxable inventory. It is likely that the ROI (Return on Incentives) for Waller County is greater than what is estimated since the tax abatement didn't cover inventory. We held the inventory values steady for analysis even though ROSS had projected a steady increase over time.

In addition to these direct benefits, it was noted earlier, the new road would open up the area to new development. At this time, the new road is complete. The improved road should be completed once ROW negotiations are finalized. Eighty-five acres have recently been purchased along that old road and a new proposed 1 million square feet of industrial space is currently being planned. The new road connects two industrial developments providing much needed mobility in support of future development. The new road now provides access to about 200 acres ready to be developed. When the road to be improved is complete, an additional 300 acres will be accessible in the fall of 2022. This is an additional 500 acres available for industrial development bringing in new jobs in an economically distressed census tract.

TABLE 1

Benefit to the RID Over Ten Years

Total Estimated Taxes	$ 41,757,094
Max Incentive Allowed	$ (5,000,000)
Net New Tax Revenue	$ 36,757,094

TABLE 2

Benefit to Waller County Over Ten Years

Total Estimated Taxes	$ 20,482,022
Estimated Incentives	$ (3,063,021)
Net New Tax Revenue	$ 17,419,001
Estimated Roll Back Taxes from Ag Exemption	$ 99,000
Savings from Terminating Previous Road Agreement	$ 2,400,000
Value of the New Public Road	$ 4,000,000
Cost of Acquiring Right of Way to Expand Existing Road	$ (600,000)
Total Benefit to the County	$ 23,318,001

Conclusion: Without getting into a separate debate regarding the value of using tax abatements or incentives in a general sense, they do represent a form of free leverage. If we are not collecting taxes now, then what do we "give up" with incentives? Remember this, unless your net new revenue is less than your prior revenue, then you are not "giving up" anything. It is mathematically impossible to show a loss or reduction in tax revenue. Even if your community is resistant to using incentives, why not use them as a way to build public infrastructure? And, you also just might land a really great company along the way.