

# **SOME THOUGHTS ON EXPERIENCES WITH THE PPEA**

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In 2002, the Virginia General Assembly enacted the Public-Private Education Facilities and Infrastructure Act of 2002, found at Section 56-575.1 *et seq.* of the Code of Virginia of 1950, as amended (the "PPEA"). The General Assembly's vision was to harness the resources and creativity of the private sector for the benefit of the public sector. This was to be accomplished by providing an alternative method for procuring public facilities and infrastructure. The PPEA and the Model Procedures "suggested" to implement the PPEA for each public entity can be found, among other places, at the Division of Legislative Services' website at <http://dls.state.va.us/ppea.htm>.

The PPEA is still quite new. Although no one can claim that the PPEA has been a good fit for every potential project, it has worked well in some cases. Further time and experience will be needed before public entities and private developers can arrive at a consensus whether the PPEA approach may be appropriate, or inappropriate, for a given public facility or infrastructure. Even with that consensus, there will always be gray areas and special circumstances to consider.

In the two years since the PPEA was enacted, public entities in the Commonwealth of Virginia and private developers have had a mixed bag of experiences with the PPEA. The purpose of this article is to provide some food for thought when considering whether to use the PPEA for a particular project. It is not the purpose of this article to provide a scholarly rehashing of the PPEA or the Model Procedures. Thus here, in no particular order, are some observations about the PPEA.

## **MODEL PROCEDURES**

Section 56-575.16(4) of the PPEA provides that a public entity that wishes to consider a request for a PPEA project must adopt procedures that are sufficient to enable the public entity to comply with the PPEA. The Model Procedures were provided in September of 2002 to give guidance to public entities in adopting their own PPEA Procedures.

For the most part, those public entities that have adopted PPEA Procedures have not strayed too far from the Model Procedures. This is much appreciated by the private developers, as it provides uniformity and consistency. Private developers fear that they may be blindsided by a non-conforming provision buried deep in a public entity's adopted Procedures. For the process to work smoothly, it may be helpful for a public entity to identify those instances in which the adopted Procedures differ from the Model Procedures.

Why should a public entity care whether life is made a little harder or a little easier for a private developer? The basic tenant of the PPEA is that the private developer will enter into a partnership with the public entity to develop a public facility that meets the needs of both parties. Consequently, both parties will benefit if this partnership begins in an atmosphere of trust, respect and mutual understanding.

Variations from the Model Procedures most often concern the fees a public entity may charge to review solicited and unsolicited proposals. For example, although the Model Procedures suggest that a public entity should return the entire fee to a private developer if the public entity determines not to proceed with the review of a conceptual phase unsolicited proposal, some public entities have left themselves the flexibility to retain a portion of the fee to compensate for the expense of making that determination. In another common variation, some public entities charge a modest review fee for a conceptual phase proposal and some charge a more substantial fee. The modest review fee is intended to encourage participation and the not-so-modest review fee is intended to limit the field to private developers that are seriously interested in the project.

## **PUBLIC SUPPORT**

Because the PPEA process is new, members of the general public may believe that the PPEA is intended to "hide the ball" and to keep the general public from understanding what the final transaction may look like. When a public entity considers adopting PPEA

Procedures, it may wish to educate the general public as to how the PPEA works and why it may be advantageous. As the PPEA process and negotiations are underway for each project, the public entity may wish to provide the general public with updates on the status of the project and the intended benefits.

### **SOLICITED UNSOLICITED PROPOSALS**

It's only human nature. A public entity's Procedures permit it to collect a review fee for reviewing unsolicited proposals, but not for reviewing solicited proposals. A public entity may desire to work with a particular private developer for a particular project. Why not just ask that private developer to submit an "unsolicited" proposal and then charge the private developer a review fee? Although this has happened on several occasions and may be perfectly legal, soliciting a private developer to submit an "unsolicited" proposal is not in the spirit of the PPEA, which is to have a fair and open system for procuring public facilities and infrastructure.

A public entity may wish to define the terms "solicited" and "unsolicited" in its Procedures to ensure that every instance of a public official "thinking out loud" about the desirability of some project is not deemed to be a solicitation for PPEA purposes.

### **FISHING EXPEDITIONS**

A public entity may wish to develop some vacant office space downtown into much-needed office space for its employees. It does not have the funds or expertise to develop the office space, but is interested in knowing what the costs and the time frame might be for sprucing up the space to make it suitable for a modern office environment. The public entity believes that it may be a great idea to solicit PPEA proposals for the project. It could then use the proposals received as free feasibility and planning studies for the project. Is it a great idea?

Even submitting a conceptual phase proposal for a fairly simple project will cost a private developer a great deal in time, effort and expense. It is a very rare private developer that does not mind putting a proposal together for a project that, in all likelihood, may never go forward. Although a public entity may be able to get away with doing this once, private developers will be reluctant to work on the next project if the public entity has earned a reputation for not being serious about following through on PPEA proposals. This does not mean that a public entity will

suffer adverse consequences if a project falls through, so long as it has acted in good faith. This does mean, however, that getting a reputation for participating in fishing expeditions could have adverse consequences for other PPEA projects down the road.

### **NEGOTIATING WITH DECISION MAKERS; NEGOTIATING FOR A DEAL THAT CAN GET DONE**

Experience tells you that you should only negotiate with decision makers. This is one reason why buying a car ("I'll have to talk to my manager") makes people crazy.

If you are negotiating a comprehensive agreement on behalf of the public entity, be sure that the private developer's representative has the power to make decisions on behalf of all of the members of the private developer's team. Since submitting a PPEA proposal typically is a significant event for a private developer, the public entity need not be too concerned with whether the private developer can move its team forward to come to a final agreement. The private developer has signaled its willingness to move forward through payment of the review fee, and the substantial time, effort and expense of continuing negotiations with the public entity.

If you are negotiating a comprehensive agreement on behalf of the private developer, be sure that the public entity's representative has the necessary authorization from the appropriate governing body or bodies and from the public entity's staff to put the deal together. If you are working with an elected representative, be sure that he or she has arrived at a consensus with a majority of the governing body and has worked closely with staff. If you are working with staff, be sure that the broad outlines of the comprehensive agreement have the blessing of a majority of the governing body. Further, it will be important to identify which public entities may need to be involved. It may be necessary to involve the school board, public service authority, industrial development authority or other owner or operator of the underlying assets.

It may be advantageous to avoid negotiating a comprehensive agreement over the election cycle when new members of the governing body may be taking office. A project that had the solid support of a majority of the governing body before the election may not have solid support afterwards. A public entity may be unable to fulfill promises made to the private developer prior to the change in membership.

### **FLEXIBILITY CAN BE GOOD**

Identifying a particular problem within certain parameters and requesting assistance from the private sector can be an effective way to solicit a PPEA proposal, so long as the public entity actually intends to solve the problem and has no preconceived notions as to how to go about it. A locality may, for example, be having trouble siting a school in a highly developed area. The public entity may welcome ideas from private developers for squeezing the school onto an existing school site or putting the school on a site owned or controlled by the private developer.

Let's say that a public entity knows that a needed public facility can be sited on half of a publicly-owned parcel and is looking for ideas for what to place on the remainder of the parcel to generate revenues. The PPEA may be a great tool to solicit creative ideas. If the public entity knows that it will only accept certain types of revenue-generating facilities or that it will never accept certain other types, it should make those preferences known to the private developers during the solicitation.

### **FLEXIBILITY CAN BE BAD**

Private developers don't have ESP. Although they can offer creative solutions to problems, they are generally incapable of hitting moving or missing targets. A solicitation, therefore, that says that the public entity wants a "park," without identifying the general area or size for the park or what amenities may be desired, is unlikely to attract any serious PPEA submissions. A very broad solicitation will raise the concern that the public entity has no idea of what it may want and is simply on a fishing expedition.

### **COOKIE CUTTERS**

A fast-growing public entity just finished the development of a new elementary school using typical procurement policies and practices. The public entity is quite happy with the design and construction and is not unhappy with the cost (it would be happier if it had been free, but ...). Due to continued growth, the public entity wants to build a very similar new elementary school on a designated site a few miles away within a normal time schedule. Is this the type of project that should be developed through the PPEA? Probably not. There will be few opportunities for a private developer to add value to the development of the new school. The public entity knows exactly what it wants, exactly where it will go, exactly how much it should cost and exactly how long

the construction should take. The typical procurement policies and practices will get the job done just fine.

### **TIME TO COMPLETION**

One of the great advantages to the PPEA is that it may be possible to get public facilities and infrastructure designed, developed and placed in service much more quickly than would be the case using traditional procurement policies and practices. Private developers can, to shamelessly borrow a phrase from a well-known courier service, move "at the speed of business." If speed is a critical factor for the development of a public project, the PPEA may be the way to go.

The ability to provide a project at greater speed may provide the one exception to the general notion that a cookie cutter project is best procured in the typical way. If a school, for example, must be developed and opened on an extraordinary time schedule, using the PPEA may be the only way of accomplishing that goal.

Using the PPEA to mimic a design-build methodology of developing a project may give a public entity greater control over the timing and expense of a project.

### **LACK OF ONGOING PRIVATE INVOLVEMENT**

In the debate leading to the passage of the PPEA, one of the benefits touted by the proponents of the PPEA was that a public entity could leave to a private developer the ownership, operation and financing of a project. While there may be a time and place for everything, the experience with the PPEA to date has been that the public entity owns, operates and finances the facility or infrastructure. As is the case with facilities procured using the traditional method, the private developer completes the project, gets paid, and then walks away. The PPEA, then, functions solely as an alternative method to procure the development of the project.

An important reason for the lack of continuing private involvement is the added expense of financing a project that is owned and operated by a private developer. Generally, such a facility will not qualify for tax-exempt financing. The interest differential between a financing at taxable rates and a financing at tax-exempt rates can be significant. This increased cost is likely to be passed along to the public entity in the form of lease payments, user fees, service

charges, or other payments due under the comprehensive agreement with the private developer.

### **OTHER FINANCING CHALLENGES**

Some PPEA proposals have indicated that the private developer desires to finance the construction of the public facility or infrastructure, and then turn the project over to the public entity upon completion of the project. While this may be an attractive option for a public entity, in that no cash outlay will be necessary until the project is completed, it has its pitfalls and costs.

Assuming that the public entity will need to borrow to cover the cost of the project, the borrowing will be at the interest rates prevalent in the market at the time of the completion of the project. Perhaps those rates will be lower than the rates in effect when construction began, and perhaps they won't. Further, a private developer will work into its fees the cost of providing construction financing. Since the private developer will not be able to borrow at tax-exempt rates and will likely have a credit rating no better than the public entity's, it is likely to have a higher borrowing cost. The public entity will bear these interest rate costs and risks.

If the private developer defaults on its financing, the public entity's access to the project may be impaired, at least until the dust settles. Although the comprehensive agreement should detail what-happens-to-whom-and-when upon a default, it is inevitable that there will be disruptions. The public entity will bear these credit risks.

### **KNOW WHAT YOU KNOW**

Another benefit touted by PPEA proponents is the ability of the public entity to make known what it needs, then leave it to the private developer to meet those needs. A project could, therefore, be designed, developed and operated without the public entity needing to hire (and pay for) its own experts to oversee the design, development and operation. Since the public entity will be paying for the project, one way or another, a better course of action would be to have a broad spectrum of professionals (architects, engineers, construction managers, accountants, bond counsel, etc.) available to the public entity to oversee such matters. If the public entity does not have such professionals on staff, or if the staff is busy with other matters, it would be best for the public entity to hire one or more professionals. The cost of hiring such professionals can be charged to the private developer with the moneys received from the review fees. A public entity should be mindful, however, that the

private developer will charge that expense back in the cost of the project. A public entity that has not negotiated a comprehensive agreement may wish to hire a professional to help it think through the items that should be included in such an agreement.

### **SIZE MATTERS; ODDS MATTER**

The submission of even a conceptual phase proposal will cost the private developer a great deal of time, effort and expense. A private developer will be more likely to submit a proposal if the size of the potential project is large enough to grab its attention. This may be a reason for grouping together two or more projects into one PPEA proposal.

A private developer will be more likely to submit a detailed phase proposal if the private developer believes that it has a reasonable chance of success. If a public entity receives 8 conceptual phase proposals and decides to advance 6 of the proposals to the detailed phase, the public entity may find that none of the private developers will submit a serious detailed phase proposal because of the significant review fee charged and the time and expense necessary to assemble a detailed phase proposal. There is no "right" number of proposals to advance to the detailed phase. The goal should be to motivate private developer teams to continue, rather than to discourage them.

Time will tell whether the use of the PPEA will become wide-spread. The idea of bringing private sector ideas and efficiencies to the public sector has merit and is worthy of serious effort and consideration. The devil, however, will always be in the details.