Public-Private Partnerships for Real Estate Development: Beyond Bridges and Roads

Leveraging New Project Opportunities and Deal Structures, and Navigating the Procurement Process and Financing Options

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Public-Private Partnerships for Public, Private and Mixed-Use Real Estate Development: Beyond Bridges and Roads

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1. Identify the public need/benefit/POLITICAL WILL at both the elected official and administrative levels - first and foremost you need a high staff level champion for your approach.

2. Identify and Quantify the Sources and Uses of Funds and the order of magnitude of the GAP.

3. Devise alternatives for filling the GAP, such as redefining the need, redesigning the product, financial restructuring (public and private sources), operating cost reductions and revenue enhancements (eg. advertising, more user fees etc.).

4. Identify the procurement authority and method that best suits our goal – look first for a sole source hook, which is rare, and then a qualification based selection process rather than a competitive fixed price bid.
I. How this Process Relates to Process for Private Use P3s

II. The Need

III. Partner Selection – Procurement Models

IV. Key P3 Deal Structures

V. Key Financing Considerations: Private v. Public

VI. Conclusion
I. How This Process Relates to Process for Private Use P3s

**A FRAMEWORK FOR LOOKING AT ALL PPP’s**

What is being built – Public vs Private: is it

A. a private real estate asset (*prior webinar*) or;

B. an asset that is either publicly owned or performing a public function with public control (*this webinar*)

*If it is a private real estate asset, is the government participation (policy driven or asset management)*

A. A manifestation of policy to create an asset that the market won’t yet justify, i.e. urban redevelopment or affordable housing; OR

B. The deployment of publicly owned property to generate revenue (while honoring policy goals)
I. How This Process Relates to Process for Private Use P3s

**HOW PRIVATE PPJV’S CAN INFORM “PUBLIC” PPP’S**

1. Formulation of clear objectives; knowing what you want and what metrics will be used for selection
2. Developer solicitation mechanisms; direct negotiation, RFI, RFQ, and RFP
3. Systematic selection procedures; committees, charts, interviews
4. Codifying the stages of negotiation and implementation; selection leads to ENA; ENA leads to documents for approval; approval triggers satisfaction of conditions; project start; project completion; ongoing monitoring and administration
THE OVERLAP BETWEEN PROCESSES

- Process overlap in solicitation and selection
- Often the same parties as principals
- Often the same professional advisory firms, lawyers, consultants and designers
- Similar balance between the not always compatible priorities of public policy/politics and economic reality
A. Need to reverse decaying US infrastructure and public facilities hampered by:

1. Decreasing confidence in and capacity of public finance markets.
2. Declining real growth in public revenues and unsustainable public employment costs and benefits.

B. P3 infrastructure and public facility investment essential to job creation and economic stability.
C. Need to develop US P3 procurement models that best leverage and couple private capital with design, construction, operation and maintenance capabilities to create:

1. Better life cycle costs and revenue production for new revenue generating projects (lower cost, higher service levels).

2. Better bottom line returns for existing revenue producing assets.

3. Lower life cycle costs for existing and new non-revenue producing assets.
III. Partner Selection – Procurement Models

A. Traditional Models - Sealed Fixed-Price Bidding : Design-Bid-Build (DBB) and Design Build (DB).


C. Sole Source Procurement.
Understand POLITICAL WILL

There is no “THERE” there without it!
A. Traditional Models - Sealed Fixed-Price Bidding: Design-Bid-Build (DBB) and Design Build (DB).

1. Most familiar to public agencies and easiest to administer without outside consultants - awarded to lowest responsible and responsive bidder.

2. DBB requires time for multiple procurements, one or more design contracts and then the construction.

3. DB permits agency to obtain one sealed fixed price bid for both the cost of design and construction based on performance standards and/or schematic designs.
III. Partner Selection – Procurement Models

4. Highly defined and regulated by laws and regulations.

5. Some room for judgment through bidder prequalification process.

6. Does not link capital investment and private sector profit motive to create an incentive for designers and contractors to optimize life cycle costs.

7. Difficult for agency using DBB to transfer risk of change orders and cost overruns caused by lack of coordination of plans and construction, but DBB does allow agency to transfer that risk.
III. Partner Selection – Procurement Models (cont’d)


1. Request for Proposal (RFP) - Structured Quantitative Based Solicitation.
   a. Permits agency to solicit fixed price offers for integrated P3 project delivery based on detailed specifications, instructions, and model contract forms.
   b. Provides an incentive for P3 team to optimize design and construction to achieve best life cycle cost.
   c. Requires agency to develop project specifications and deal structure without the benefit of private partners’ innovation and input for more mutually beneficial approach to project.
   d. Predetermined project specification and deal/financing structure may preclude proposers and solutions which would provide the optimal result for the agency.
2. Request for Information (“RFI”) and Request for Qualification (“RFQ”) - Qualification-Based Solicitation.

a. Allows agency to begin procurement based on its “vision” for the project by inviting potential private partners to submit their qualifications, capability and concepts for project delivery.

b. Allows agency to evaluate and begin discussions with one proposer or a short list of proposers based on subjective factors such as qualifications, track record, financial capability, and approach to the process.

c. Agency may preliminarily select and grant an exclusive negotiation agreement (“ENA”) to one proposer terminable by the agency, in its sole discretion, if agreement is not reached on the concept, design structure, economic or other features of the public private partnership.
d. ENA may provide for cost sharing for predevelopment/design costs in the event the partnership is not formed and the agency decides to abandon the project or begin negotiations with another proposer.

e. Allows collaboration on project scope, phasing, design, financial, operational and maintenance parameters and overall deal structure so as to optimize use of each parties unique capability, funding sources, expertise, tax considerations and capacity.

f. Optimizes potential for innovation and allows parties to coalesce both taxable and non-taxable forms of public and private capital – accommodates any form of deal structure.
III. Partner Selection – Procurement Models (cont’d)

g. Accommodates a true and transparent partnership based on “open book,” cost-based pricing, metrics and performance standards which can be reviewed and audited throughout the life of the partnership.

h. Will generally provide the most cost and time effective procurement and will promote compatibility of design, cost, availability and cost of capital and functionality of the project delivery elements.
C. Sole Source Procurement.

1. Can be extremely flexible, but at the cost of competition and (sometimes) transparency. Appropriate for emergencies or situations where only one bidder can feasibly provide service or physical infrastructure, but open to manipulation by proposers and regarded with suspicion by courts and legislators. Highly regulated.

2. In order to encourage and not discourage providers to invest in developing and bringing highly innovative and superior solutions to the agency, may want to consider doing a qualification based procurement while preserving until after selection the confidentiality of the unique approach advanced by unsolicited proposers.
IV. Key P3 Deal Structures


C. Existing Public Assets: Revenue Generating.
IV. Key P3 Deal Structures


2. Typically funded on a taxable basis with lease or sale leaseback but may be funded alternatively or in combination with tax exempt financing. Life-cycle cost reduction can more than offset nominal spread between taxable and tax-exempt interest rate (see Key Financing Considerations below).

3. P3 teams offer private sector equity, problem solving, R & D, new technology or innovative strategies: long-term improvements in design, construction and operation – in exchange for a return that recognizes risk they take.

1. (A)(1)-(A)(4), outlined above, all apply.

2. May not be appropriate for Greenfield projects such as toll roads and rail, where the use is not sufficiently predictable—risk of unpredictable revenues may result in extraordinary premium. It may be better to design-build until use revenue is seasoned. The asset could then be monetized per Existing Asset classes below.
C. Existing Public Assets: Revenue Generating.

1. “Full Monetization” or “Concession” model.

   a. Full monetization of assets based on highest price offered for long-term lease of asset where all or substantial net present value of lease payments is paid to Agency up front and Concessionaire takes asset revenue stream for duration of term (e.g., 50 years).

   b. Public sector “transfers all risk” to private sector, but foregoes future upside from revenue growth and operational efficiencies.

   c. Pure concession model does not provide protection for competitive user fees vis-à-vis level of service.

(i) Agencies avoid these risks through fixing prices / price increases and setting minimum service standards, while leaving certain other operational factors open to concessionaire.
d. Although pure concession has the surface appeal of fixed price bidding, it lacks transparency with respect to cost of funds, potential for revenue growth, operational efficiencies and revenue and other risk premiums, all of which together with cost and revenue assumptions are buried in the single up-front concession payment bid.

e. Public policy problems: encourages agencies to relinquish long-term control of valuable asset in order to satisfy short-term financial needs, and threatens the long-term fiscal health of the agency—long term leasing the entire orchard for one discounted prepayment leaves no fruit for future generations.

2. True Partnership/“Lease-Leaseback” Model.

a. Particularly for assets with an established, existing, predictable revenue stream, such as urban offsite parking or parking meters, the agency can rationally decide to use its credit to guarantee all or a portion of the existing revenue stream, and partially monetize the asset at taxable bond interest rates, while retaining a substantial sharing of future revenue growth and operational efficiency. The more the agency guarantees the existing revenue stream, the greater potential for immediate monetization.
(i) Compare to the concession model, where the cost of funds can be drastically lowered from the opportunistic returns implicit in many concession deal structures that build in risk of revenue regression and the disconnect between government regulatory control and public revenue incentives downstream. Greater flexibility because public sector can decide how much risk to allocate internally and how much to transfer to private sector.

(ii) Public sector can still fix prices and rate increases and set minimum service standard, though by not doing these things, the public sector can generate a greater range of monetization and risk transfer options.
(iii) Also creates greater competition in terms of lowest use prices and highest service level. Supports “open book” cost-based pricing and disclosure of all contingencies on front end and during operations under the lease.

(iv) Ideal for complex operating assets that involve interplay between government regulatory control and private operations and maintenance (such as airports).
b. Can be funded based on fully-disclosed cost of funds rate which approach taxable bond rates for similar credit, and allow the agency to allocate between the size of the up-front payment and the share of annual revenue-sharing and growth it wishes to achieve.

c. Operations and maintenance often transferred to private company, which gets lease payment and/or portion of upside from efficiency improvements. Operations and maintenance need not always be transferred, however: with a “Lease-Leaseback,” the asset is leased to a private entity for an up-front lease payment, and then leased back to the public agency in return for set lease payments which amortize the up-front payment over the life of the capital lease. The public agency (in working with the private entity) may or may not transfer operations and maintenance responsibilities.
d. This method allows the agency to tailor a partnership which best suits its need for current capital versus future revenue growth, desire for rate and level of service control, and need for transparency and accountability with respect to cost of funds, operating costs, and private-side profitability—as in any partnership, the books are open to both partners.

e. Case studies: Budapest, Dusseldorf, Hamburg, Athens airports (Hochtief).
A. Several factors militate against the obvious superficial conclusion that private capital is more expensive than tax-exempt bond financing an agency may be able to issue:

1. The current narrow nominal spread between tax-exempt and taxable interest rates.

2. The life-cycle cost savings and revenue enhancements achieved through integrated P3 procurement.

3. The significantly higher effective cost of tax-exempt financing when issuance, underwriting, reserves and credit enhancement costs are considered.
4. The cost and revenue impacts of tax-exempt bond legal restrictions and requirements as well as issuance uncertainty and pricing fluctuations in the public markets.

5. The likely loss of income tax deductions for interest expense, depreciation, property taxes, etc.

6. Tax exempt structure may deprive public agencies of property and other tax revenues.
B. The result is that comparing an A-credit nominal tax-exempt rate of X% with an A-credit nominal taxable rate of Y% is fallacious. When 1-6 above are considered, the actual finance costs and available proceeds achievable using a taxable private ownership structure rather than tax-exempt bonds will be much more favorable that the nominal rate difference would indicate.
VI. Conclusion

A. Procurement and P3 structures both benefit from flexibility, competition and transparency.

B. These factors lead to lower costs and/or greater returns to public sector, including job growth and economic development.

C. Public sector must be sensitive to private sector financing and profitability requirements needs—the greater sensitivity, the more successful the procurement will be in optimizing the use of private capital.

D. Flexibility in selecting and tailoring procurement and deal structure models that best match the particular asset class, market and economic setting, public policy objectives and political reality is key— one size does not fit all.
Public-Private Partnerships (P3)

P3 Strategy Dimensions

GOVERNMENT

FEDERAL
STATE
LOCAL
OTHER

RESIDENTIAL
INFRASTRUCTURE
INDUSTRIAL / OFFICE
OTHER

MASTER DEVELOPER
FINANCIER
OPERATOR / MANAGER
OTHER

ROLES / FUNCTIONS

ASSET TYPES (USES)
Public-Private Partnerships (P3)
ULI Framework for P3 Process, Analytics, Methods

- **Purpose / Need / Endgame?**
  - Economic: job creation, economic development, tax base
  - Financial: lower O&M / capital improvement costs
  - Social: improve service delivery to users / taxpayers
  - Environmental: green technology, brownfield redevelopment

- **Procurement Type?**
  - Request for Qualifications (RFQ)
    - Taxable
    - Non-taxable
  - Request for Information (RFI)
    - Industry forums
    - Idea search
  - Request for Proposal (RFP)
    - Competitive bid
  - Single Source
  - Evaluation factors / weighting
  - Deal points

- **Best “Fit”?**
  - Exclusive agreement
    - Planning
    - Contract Negotiation
  - Feasibility
    - Cost / Benefit
    - Economic Analysis
  - Business Case
  - Planning costs
  - Opportunity costs
  - Lifecycle costs
  - Public Comparator
  - Value for Money (VfM)

- **Results / Lessons for Future?**
  - Economic
  - Financial
  - Social
  - Environmental
  - Efficiency / Effectiveness / Equity
  - Repeatability
  - Fungibility
### Public-Private Partnerships (P3)

#### Project Analysis TO BE COMPLETED FOR EACH PROJECT

<table>
<thead>
<tr>
<th>Taxable</th>
<th>Non-Taxable</th>
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</thead>
<tbody>
<tr>
<td><strong>Public Agency</strong>&lt;br&gt;Pluses (Minuses)</td>
<td><strong>Private Sector</strong>&lt;br&gt;Pluses (Minuses)</td>
</tr>
<tr>
<td>Project Tax Revenues</td>
<td>Potential Income Tax Deductions&lt;br&gt;Interest, Taxes and Depreciation</td>
</tr>
<tr>
<td>No Tax Exempt Restrictions on Use of Funds</td>
<td>No Tax Exempt Use/Operational Restrictions&lt;br&gt;(Higher Nominal Interest Rate)</td>
</tr>
<tr>
<td>Lower Nominal Interest Rate&lt;br&gt;(Bond Issuance Costs)</td>
<td>Lower Nominal Interest Rate&lt;br&gt;(Tax Exempt Use/Operational Restrictions)</td>
</tr>
<tr>
<td>(Bond Issuance Capacity)</td>
<td>(Bond Issuance Costs)</td>
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Private Financing / Public-Private Partnerships

California Infrastructure Financing Act: A Flexible Tool for Innovative P3s

- Qualification-Based Procurement Process
- Fixed-Price Bidding Prohibited
- Applies to “Fee-Producing Infrastructure”
  - Legislation now being considered to clean up issues with CIFA

California Examples
Cerritos Towne Center

125-Acre parcel purchased by the CRA
Dec. 24, 1987
Cerritos Towne Center Development began with Hotel, Office and Performing Arts Center.
Cerritos Towne Center

Cerritos Towne Center Today

- 1,000,000 square feet of office buildings
- 600,000 square feet of retail
- 200 room hotel with conference center
- Performing arts center
- 4,964 permanent jobs
I. Before developer selection

A. Agency purchased the 125 acre former dairy site.

B. Agency planned and entitled the site including all discretionary approvals.

C. Agency plan was carefully calculated to achieve land use compatibility with existing adjacent public facility uses such as City Hall and high school, as well as future needs such as performing arts center, public safety center and library.

D. Agency planned commercial uses reflected a realistic economic and market driven balance of both job generating office, community and regional serving retail and hospitality.

E. Agency graded the site and installed backbone infrastructure and perimeter landscaping / hardscaping that established the quality and character of the development and an assessment district that would capture reimbursement from future ground lessees.
II. Qualification based developer selection, DDA and ground lease process

A. Agency was patient through the selection process in searching for developers that had the expertise, track record and financial wherewithal to do the job — when economic or other incompatibilities were apparent and could not be resolved in a reasonable time, agency went on to another developer and went through several during the process.

B. Agency split award in 2 — one office / hotel developer and one retail developer but did not allow those developers to further split the development responsibilities and rights to others.

C. DDA was structured as a series of options to ground lease that reflected the agency’s use and timing expectations and included a form of ground lease with established ground lease terms.
II. Qualification based developer selection, DDA and ground lease process

(cont’d)

D. Significant deposits were required, but no pre-development land holding cost was charged until the DDA was approved and first ground lease option was scheduled for exercise. That, together with all entitlements being in place, allowed agency to attract strong developers and optimize long term rent, escalations and other lease terms.

E. Agency used 99 year unsubordinated ground leases with CPI increases designed to optimize financeability and provide for a long term inflation protected financial asset — universe of ground lease construction and permanent loan lenders was small and availability and cost of financing would impact amount of rent agency could command.

F. DDA and ground leases established agency land use control objectives by contract beyond the City’s police power land use regulatory rights.

G. Agency was very exacting about tenant selection for the retail component as well as development standards — Sam Walton and the granite Walmart and the bullocks, buffums or better clause.

Cerritos Towne Center
Victoria Gardens – Forest City
Victoria Gardens – Forest City

Victoria Gardens, Rancho Cucamonga, California “New Downtown” Master Plan:

2.45 million square feet of retail, office, and civic uses as well as up to 600 previously approved multiple-family residential units

52% residential completed
57% commercial, office, and civic uses completed
Victoria Gardens – Forest City
Victoria Gardens – Forest City
Victoria Gardens – Forest City
The Boulevards at South Bay

LARGE MIXED USE PROJECT WITH MAJOR LANDFILL REMEDIATION

- City of Carson at intersection of 405 and 110

- Project split between infrastructure / remediation zone and vertical – airspace subdivision

- 168 acres, Illustrative Plan of up to 2 million Sq. Ft. of commercial retail, office and hotel, plus 1,500 residential units, subject to equivalency

- LNR/Hopkins developer and the City and RDA

- Post Lehman need to restructure public financing model
LARGE MIXED USE PROJECT WITH MAJOR LANDFILL REMEDIATION

• The City will provide $120 million of public assistance to the project to fund remediation and public improvements

• Air space subdivision and land use entitlement

• Defense of the entitlements from challenge under CEQA

• Structure, negotiation and documentation of the public private partnership

• Statutory development agreement with the City vesting the developer’s entitlement rights

• Owner Participation Agreement documenting the Agency’s financial assistance to the project and establishing a non-profit mutual benefit corporation funded, in part, by a Communities Facilities District, to hold and manage the below-grade remediation

The Boulevards at South Bay
Westfield Culver City

ACCOMMODATE TARGET AS NEW ANCHOR AND ADVERTISING SIGNS

• Existing mall adjacent to the 405 freeway in Culver City

• The renovation includes the addition of approximately 300,000 square feet to the existing regional mall, including a new Target store, a new Best Buy store and a comprehensive Freeway Onsite Sign Entitlement.

• Westfield, City and Redevelopment Agency

• RDA assistance and Sign income allowed redevelopment, with new major tenant, of obsolete 1960’s mall that did not have freeway presence.
Westfield Culver City
1. Lost opportunity for city to use that 405 access and visibility to energize the “FORGOTTEN SIDE OF THE CITY”

2. Robinsons May goes dark and Westfield buys the pad

3. Westfield redevelopment plan projects a very large gap between cost to redevelop and after value
4. AFTER OVER 2 YEARS OF NEGOTIATIONS AND ENTITLEMENTS ON A 3/2 VOTE CITY/AGENCY APPROVES:

A. $10 million rebate out of new tax increment to be generated, subject to performance standards:

   (1) TENANT MIX, QUALITY AND QUANTITY

   (2) TIMING, QUALITY AND COST OF IMPROVEMENTS

B. FREEWAY VISIBLE SIGNAGE, which together with the center’s redesign, attracted consumers off the 405 – this also provided traffic needed to revitalize surrounding area. For the signage, the City received a base payment and 50% of sign advertising revenue in excess of a threshold return to owner.
OVERVIEW OF PROGRAM ORIGIN

• In late ’90s Los Angeles County decided to abandon the traditional design bid procurement method for its major new office buildings

• Went to RFP process for turnkey design build with bidders to provide sites and buildings at fixed cost

• Reasons for change and advantages sought
  – Benefits of design build and turnkey with developer absorbing construction risk
  – Accelerated delivery
  – For County programs with operating revenues reimbursed by the state or Feds, the rent paid on the leaseback is eligible for reimbursement (note operating vs capital lease issue)
PROGRAM RESULTS

• Since the late ’90s Los Angeles County has developed more than eight buildings representing more than $200 million in new investment through the program.

• The selection process has been refined in two ways; (1) better to assure site control; and (2) how better to categorize costs first as between documented third party costs and developer “retained” fees and second as between “known” costs and those subject to risk of change.

• Refinement of distinction between operating and capital leases in response to greater scrutiny of reimbursements.

• The related and complex issue of pricing the option to purchase.
Connecticut Gov. Dan Malloy signed into law a jobs bill on Oct. 27 that allowed state agencies to engage in infrastructure P3 deals for the first time.

Both houses of the Connecticut General Assembly passed the bill in a special session on Oct. 26.

The new law listed several requirements for P3 deals in Connecticut, including the following:

• funds for a P3 deal cannot exceed 25% of the total cost of a project,
• P3 deals the governor must approve all P3 deals,
• state can be used for transportation and transportation-related projects, including ports and railroads, as well as educational, housing and early childcare facilities,
• the governor cannot approve more than five P3 deals before Jan. 1, 2015.

Source: Infra-Americas
“The governor’s office did not have any specific projects in mind. This is simply a new way to finance infrastructure in the state,” said Gian-Carl Casa, undersecretary for legislative affairs at the Office of Policy and Management.

During the gubernatorial election last year, Republican candidate and former Lt. Gov. Michael Fedele outlined several potential P3 projects, including privatizing the 200 parking lots along the New Haven Line of the Metro-North Commuter Railroad and privatizing the Bradley International Airport.

Malloy campaigned against privatizing state assets during the campaign and beat Fedele in the election.

Source: Infra-Americas
Illinois Governor Pat Quinn signed into law Aug. 27 House Bill 1091 (HB 1091), also known as the P3s for Transportation Act, which enables the Illinois Department of Transportation (IDOT) to engage in P3s for new surface transportation projects.

The bill has been discussed in the state's House of Representatives since the beginning of the year, when its authors, Rep. Elaine Nekritz (D) and state Senator Heather Stearns (D) introduced it.

Illinois is now among 30 US states to have passed laws that give respective state departments of transportation the authority to contract private bidders to design, build, finance, operate and maintain surface transportation projects.

The provisions of HB 1091 require that the state’s General Assembly approve all potential P3s; that the state’s Commission on Government Forecasting and Accountability conduct independent studies of proposed projects; and that existing toll ways can only be leased to maintain the toll way, and not for monetary gain.

Source: Infra-Americas
Both houses of the Pennsylvania legislature approved a bill (House Bill 3) in late June enabling P3 structures for transportation projects, and Gov. Tom Corbett signed it on Jul. 5.

HB 3 was unanimously approved by the Senate on Jun. 30 and then gained House approval by 117 to 79, with strong bipartisan support.

The legislation, sponsored by House Transportation Committee Chairman Rick Geist (R-Altoona), provides a broad-based framework authorizing transportation-specific P3s.

Two projects that could be excellent candidates for P3s are the addition of two HOT lanes to a portion of Route 422, to ease congestion, and the rehabilitation of I-95, once Pennsylvania receives permission from the federal government to gain tolling authority on the highway.

Source: Infra-Americas, July 6, 2012
CLOSING