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Basic considerations associated with the use of public-private partnerships (P3s) by colleges and universities with a focus on energy/utility P3s

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Higher education institutions increasingly leverage P3s to deliver campus projects, including with respect to energy and utility assets, instead of traditional project structures that involve the institution owning and funding the assets.

Although P3 projects have common themes, their features vary widely from project to project. This note focuses on some of the basic drivers, objectives, and issues that are likely to arise in various types of P3 projects that universities and colleges might undertake.

Why consider a P3 in the first place?

A higher education institution may consider utilizing a P3 for a variety of financial and nonfinancial reasons.

From a financial perspective, a P3 might reduce the institution's near-term capital expenditure requirements and long-term life cycle costs. A P3 might provide greater long-term cost certainty related to the assets or services provided as part of the P3. To the extent the P3 involves collecting revenues from third parties, the P3 may reduce or eliminate the institution's historic collection risk related to such revenues.

From a nonfinancial perspective, a P3 might allow an institution to shed to the private sector the responsibility of providing services or assets outside of the institution's primary mission of providing education.

Separately, the institution may be able to raise overall performance standards for services provided. For energy-related assets, this could include energy efficiency and a reduction in carbon emissions.

Different approaches to P3 projects

The diverse range of services, facilities, and buildings on university and college campuses generate numerous opportunities for P3 arrangements. However, the objectives and considerations vary considerably across different types of assets.

Typical examples of facilities that might be the subject of P3 projects include, among others: campus parking; energy and utilities; student housing; and construction of academic, sporting, or other university facilities. These four examples of common P3 facilities provide a good basis to illustrate how the features of a P3 project structure can vary from asset to asset. The following table offers a summary.

	Energy and utility privatization	Campus parking	Privatization of student housing	Construction of university facilities
Financial objectives	Achieve best life cycle cost (taking into account both initial funding and operation and maintenance)	Maximize capital receipt	Maximize capital receipt	Achieve best life cycle cost (taking into account both initial funding and operation and maintenance)
Service objectives	Reliable supply and maintenance of utilities to a standard Specified performance standards	Well-managed parking facilities and service requirements such as annual permits	Good quality accommodation for students, maintained in accordance with contractual standards	New assets, built to match the university's specifications and maintained in accordance with contractual standards
Revenue comes from university or from other end user?	University, often through a "take or pay" off-take agreement	End user	End user	University, probably as "availability payment"
P3 contract limits rate of change on charges to end user?	Yes	Yes	Yes (if sole provider)	Rate of availability payment fixed, but linked to appropriate index
Upgrade of existing assets required, new assets, or takeover of existing assets in good condition?	Varies (see below)	Varies (see below)	Varies (see below)	New assets, built to match the university's output specification
P3 agreement specifies levels of service required?	Yes	Yes	Yes	Yes
Payments/revenue deductions for shortfalls of service?	Yes	Yes	Yes	Yes
Transfers required of existing university staff?	Varies (see below)	Varies (see below)	Varies (see below)	Varies (see below)
Specify handback condition for end of P3 agreement?	Yes	Yes	Depends on whether on or off campus. Yes, if on campus.	Yes

Key considerations

When engaging in a P3 project, institutions should consider the following factors.

(a) Institutional objectives

Many organizations omit the fundamental objectives of a P3 project. Clarity on objectives is critical before a P3 arrangement is pursued in order to ensure that (i) all objectives are achievable and (ii) the P3 project's structure and the associated request for proposals are developed to achieve the fundamental objectives.

For example, when privatizing an institutional function, one consideration is whether or not to look for a capital receipt. On one hand, it may appear obvious that if the institution transfers or leases assets to its private partner, then it should look for a capital receipt in relation to those assets. However, for projects related to utility provision on a campus, any up-front capital payment from the partner would be amortized from the private partner's revenues. In most situations, the institution itself would subsequently be the primary off-taker (and therefore the primary payer) for the utility services. Consequently, any capital payment may simply be reflected in higher utility charges on a year-by-year basis.

As a further example, in most P3 projects, the institution must consider the extent to which service standards and specifications are necessary. But the higher the specification or quality standard, the more the project will cost, and this will materialize in lower capital receipt (where that is applicable) or higher payment from the institution for services delivered by the P3 project. Often we see first draft agreements where service level specifications are very high, which will flow through to project costs. A balance must be struck to avoid such downstream consequences, while still holding the private partner to a rigorous, measurable, and achievable service level specification.

(b) Service specifications

Service specifications drive the value of a P3 project, but formulating and writing such specifications merits a different approach from a conventional project. Typically, a specification for a conventional project will specify how an asset must be constructed, or how it must be maintained. To get the best value from a P3 project, the specification should focus on outputs required from the project, and where appropriate leave the private sector bidders free to decide how they should achieve those outputs. That way, the private sector bidders may find innovative ways to deliver the required service from the assets they will own and manage.

As an example, consider a campus parking project. One must determine how to specify the required service. Campus parking typically includes a mix of parking lots, parking garages, and on-street parking, and the majority of revenues often come from annual permits, which may be purchased by faculty, employees, and certain students, with other revenues being generated by transient campus visitors. An on-campus P3 parking contract would present the private partner with an exclusive right to a service that the users cannot avoid using (and paying for). Accordingly, the P3 contract should include:

(i) Clear specifications on the standard of the services required (including the number of permits to be made available and who can purchase such permits).

(ii) Clear limitations on the rate of increase of the parking charges, linked to an objective standard such as the escalation of the relevant consumer price index.

However, great care should be taken in this context to ensure that the restrictions are not greater than they need to be, as unnecessary restrictions may constrain the value achievable from a project.

(c) Taking over existing assets

Often P3 projects will involve transfer or lease of existing assets to the private partner. The institution must understand the condition of the assets and must determine how to manage elements of "backlog maintenance/renewal" that the private sector partners may need to undertake at the point that they take over the assets. The assets' condition affects the private sector partners' financing plans and the service levels that can be imposed realistically under a P3 contract prior to addressing the backlog.

It is equally important for the private partner bidders to know the condition of existing assets. The institution must decide whether this will be achieved through its surveys or studies of the relevant assets

that it has commissioned or otherwise performed, or whether the P3 partner will undertake its own surveys. If the latter, the institution must allow the bidders' surveying teams the necessary access to carry out their due diligence.

(d) Management of potential employee concerns

The transfer of some part of the institution's relevant workforce (or at least the management of some part of that workforce) to the private sector partner may be necessary or desirable to get the best value from a P3 project. This could be unsettling for the institution's workforce, and at worst can lead to strikes or other labor force action. Issues for consideration include:

(i) Preservation of pension rights and/or requiring the private sector partner to provide a broadly comparable pension.

(ii) Managing responsibility for the rights and duties as between the employees, the institution, and the private sector partner before and after any transfer of workers.

(iii) Requiring the private sector partner to pay wages and provide benefits (such as health insurance and pension plans) broadly comparable to specified grades of the employees.

One approach to address this issue is to "second" or "lend" the employees to the private sector partner, rather than to provide for an outright transfer of employment.

(e) The P3 project must be integrated into the existing financing structure

Universities and colleges incur long-term debt obligations to finance their capital needs through structures involving general obligation bonds, revenue bonds, and other instruments. The related bond documents often include covenants restricting various activities of the institution while debt is outstanding.

P3 projects must be integrated with the outstanding debt structure. Any covenants in the institution's bond documents, including the pledge agreements, and any credit provider documents related to the pledged revenues and the ability of the institution to sell or lien the assets generating these revenues must be evaluated to accommodate a P3 project. A private partner's finance providers will require first ranking liens over the relevant assets and/or revenue streams for a P3 project.

(f) Management of the procurement process

The structuring and operation of a fair and transparent bidding process is critical to stimulate a vigorous competitive bidding process, resulting in the best value for the institution. The procurement process must strike a balance that permits dialogue among bidders and the university (more dialogue than is typical in a conventional procurement) while maintaining a transparent process that gives winning and losing bidders confidence in the outcome (and minimizes the risk of challenges to the procurement process).

Energy and utility P3s

University P3s in the energy and utility sector are increasingly common over the past several years. Some examples of P3 projects in various stages of completion or planning that relate to energy or utility projects include:

- **Ohio State University** attained financial close in July 2017 on a project valued at approximately US$1.02 billion with a term of 50 years. The financing came through a mix of equity, loan financing, and capital market financing. The goal of the project was to reduce energy consumption by 25 percent over the first 10 years.
- **Dartmouth University** issued a request for quotation in February 2019 and expects to make a decision by May 2020. The project is anticipated to be valued at approximately US$200 million with a term of 30 years. The project relates to a district heating plant and distribution system, including a thermal generation facility powered by renewable energy, a new hot-water distribution system, and system converting steam to hot water. The ultimate goal would be to reduce greenhouse emissions by 50 percent by 2025 and 80 percent by 2050.
- **The National Western Center**, a 250-acre campus in Denver, Colorado, created by founding partners of the city and county of Denver, **Colorado State University**, Western Stock Show Association, Denver Museum of Nature and Science, and History Colorado, issued a request for

proposals for Campus Energy with the assistance of Hogan Lovells (as counsel to the city and county of Denver) and is currently negotiating a Campus Energy agreement with EAS Energy Partners. The current energy concept features a sewer heat recovery system to transfer heat between an adjacent sewer main and an ambient campuswide piping distribution loop.

- **Fresno State University** announced a short list of potential private partners in January 2019 following a request for quotations the prior year. A request for proposals is expected in the fall of 2019. The project is estimated to be valued at approximately US$130 million and have a term of approximately 40 years. The P3 project will create a central utility plant, ancillary infrastructure, and improve energy efficiency across the campus by replacing central heating and cooling plant equipment; chilled water and heating; hot water piping distribution systems; energy management controls; and heating, ventilation, and air conditioning systems.
- **University of Iowa** released a request for quotation in April 2019 with responses expected in June 2019 and financial close by the end of 2019. The project is estimated to be valued over US$150-$200 million with a term of 50 years. The goal will be to eliminate the use of coal in favor of renewable energy resources and potentially biofuels by 2025.

Several other universities have been in the planning stages for various new projects, upgrades, and consulting and operation assistance. As a way to encourage P3 projects, the **state of Illinois** passed a bill in May 2019 that would allow public universities to install on-site renewable energy with power purchase agreements for up to 25 years, which makes it easier to enter into solar P3 projects.

The objectives of many energy P3 projects are to shift the upfront capital costs for needed or desired energy infrastructure to the private sector and reduce the long-term costs of energy consumption on campus. The energy infrastructure can include the replacement of existing energy infrastructure or addition of new energy conservation or efficiency equipment or renewable energy generation.

Most energy P3 structures involve the private sector purchasing and installing the needed or desired energy infrastructure. The payment mechanism for energy P3 projects can vary and ranges from the institution purchasing energy from the private sector to a split of energy cost savings between the private sector and the institution. The structure of an energy P3 is a function of the institution's specific goals.

Conclusion

P3 projects continue to offer universities and colleges innovative and cost-effective ways to implement a range of projects for the benefit of the institution, its students, and its private partner.

However, numerous considerations figure at every stage of the P3 process, from deciding when to use a P3 structure to determining the appropriate project structure and establishing the process to manage a P3 procurement process. Myriad considerations are described above, but this list is not exhaustive as much depends on the specific needs of the institution and the particular circumstances of the project.

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