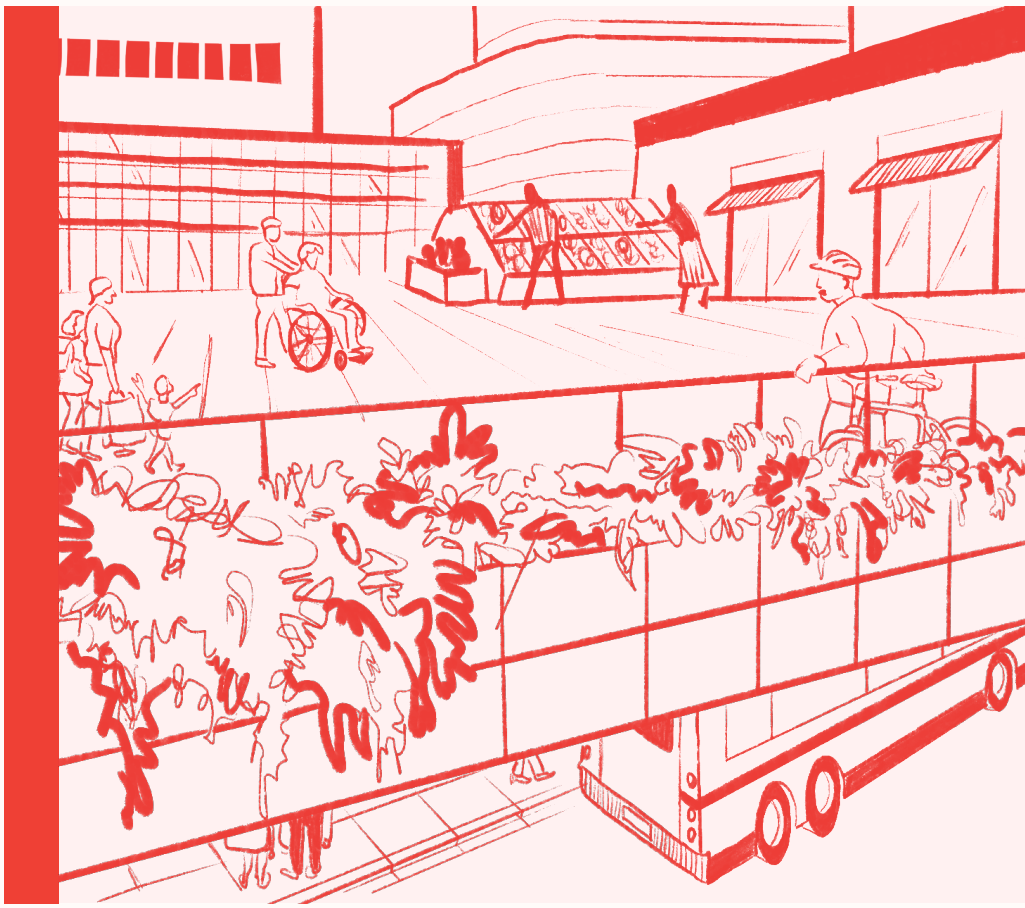
Infrastructure and Tod P3s:

Fostering Competition and Allowing For Flexibility



In this third and final article in the series[1], we compare infrastructure and TOD P3s in terms of how they foster 1) competition and derive the best value-for-money and 2) allow for flexibility to readily adopt to market changes and stakeholder demands. Our point is that infrastructure P3s excel on the former and TOD P3s excel on the latter. And while these are not exactly opposing traits, the ideal is that each P3 type should incorporate elements of each.

---

[1] See: Most of the material for this article is based on a paper written by Sasha Page, Marcel Ham, Christine Shepherd, "Comparing and Contrasting Design-Build-Finance-Operate-Maintain (DBFOM) and Master Development Agreement (MDA) Public- Private Partnerships (P3)" (https://lnkd.in/dH8UTRvk), Build America Center, October 2024. Some of them can be reached at Sasha.Page@RebelGroup.com, Christine.Shepherd@RebelGroup.com, and Marcel.Ham@RebelGroup.com.)

1. INFRASTRUCTURE P3S ARE FOCUSED PRICE, MAYBE TO THEIR DETRIMENT

Infrastructure P3s maximize price-focused competitive pressure. Total competitive pressure on whole lifecycle costing and risk valuation is achieved in a two-step, hard bid procurement, **as bidders provide committed bids on fixed scopes.** The Howard County, MD Courthouse P3 in Box 1 is an example of robust infrastructure P3 competition.

BOX 1: SUCCESSFUL COMPETITIVE PRESSURE IMPLEMENTATION IN AN INFRASTRUCTURE P3

Howard County Courthouse infrastructure P3 (Columbia, MD): While there is no set formula for maximizing competitive pressure in an infrastructure P3, there are some important criteria that stimulate "successful competition" during a procurement: impactful marketing of the opportunity (typically via an RFI or and "industry day"), a high degree of communication between the public agency and bidders, shortlisting of qualified bidding teams, an adequately long procuring timeline, and an extensive yet efficient evaluation process, culminating in a robust number of complete, committed bids, ideally typically at least three.

The example of the Howard County Courthouse infrastructure P3 illustrates the confluence of these criteria, resulting in a competitive procurement. To solicit its preferred partner for its long-needed new court facility, the County led a competitive, 11 month-long procurement, with the following key features:

- **Successful marketing:** The County initiated the procurement process with an "Industry Day" to market the project and demonstrate that the County a) understood what it is doing, b) was committed to implementing the project, and c) had a clear plan. The County then issued an RFQ, yielding nine interested bidders, demonstrating significant market interest. The County then shortlisted the three teams, who were then invited to respond to an RFP, which yielded three complete, fully committed proposals.
- **Commencing the RFP stage with a reasonable, marketable and financeable project agreement:** By making a strong effort to present a reasonable set of contract documents from the beginning, the County empowered bidders to focus on material issues and optimize bids, instead spending significant time, effort, and resources on renegotiating an unreasonable project agreement.
- **Transparent dialogue with shortlisted bidders:** The County initiated the RFP process with individual introductory meetings for bidders, followed by three rounds of one-on-one discussions over four months to discuss risk allocation and value-for-money opportunities. This approach, while deviating from typical County procurement practices, was appreciated by bidders, as it allowed them to bring up their suggestions to enhance the project agreement and better understand the County's goals and objectives, both of which engendered stronger and more competitive bids.
- **Predictable and clear evaluation methodology:** The County developed robust and explicit evaluation criteria and an evaluation method, distinguishing technical and financial criteria, with a clear formula for evaluating the financial proposal and with robust descriptions of the technical criteria, allowing the bidders to understand what was most important to the County and compete on those terms. This contrasted with other RFPs that employ vague evaluation criteria and an unpredictable evaluation method, which often disempowers competition as bidders are less likely to know on what to optimize their bids.

Photo credit: HOK

However, the public agency may not always be receiving "best value." For one, **lowest price does not always mean best value.** While many procurement scoring programs lend significant weight to technical proposal quality, financial scores are often the determining factor in winning bids. This focuses the procurement on reducing costs, even if this results in a lower quality project and/or future litigation as

developers challenge technical requirements to obtain cost relief.

Second, the increased **market uncertainty** characterized by high interest rates, construction inflation, and volatile commodity pricing in recent years has made pricing more difficult and led to more provisions for unforeseen circumstances, which diminishes the ability to achieve "best value"—and can be a recipe for deal breakdown.

Third, **high transaction costs** also contribute to the strain on competition in infrastructure P3s. Due to the hard bid procurement, bidding teams must put together comprehensive technical and financial proposals. Because of the level of financial and technical commitments required, the designs must be very advanced, and the financing needs to be fully developed. This results in "pursuit costs" of several million dollars per bidding team.[2] Considering this high opportunity cost of a committed bid in a market contending with volatility, the incentive for the developer to participate is less compelling, **diminishing the opportunity for robust competition.**

Finally, after financial close, in general **there is little or no competitive tension nor competition,** in case there are required changes to the project. In a well-structured contract these changes are well-thought, out, including how to price such "change orders." However, it is rare that these measures fully contemplate all scenarios, so that their resolution means relying on other mechanisms like benchmarking, the use of an independent engineer, or a dispute resolution process, with sub-optimal outcomes.

2. INFRASTRUCTURE P3S ARE LESS FLEXIBLE

In addition, infrastructure P3s are not flexible in light of market and stakeholder needs. As discussed earlier, in times of increasing economic, political, and environmental uncertainty, the **importance of contractual flexibility** cannot be understated. Clearly, the period during COVID and the spike in inflation thereafter is one of those periods. **The upfront, fully committed financing of infrastructure P3s can hinder flexibility.** "Fully committed" refers to having all necessary funds secured and legally committed by lenders or investors upfront. This level of commitment makes it more difficult to accommodate changes, especially larger changes that would come with larger capital costs, because 1) the two parties would have to restructure their financing arrangement, likely causing breakage costs[3] and 2) these financing arrangements do not have much wiggle room, as they are highly leveraged and have low margins. As a result, accommodating the truly unexpected can be more costly due to these rigidities, and flexibility is sacrificed.

Balancing a public agency's desire to capitalize on the creativity of the developer and the highly defined nature of infrastructure P3s prior to financial close **creates a natural tension.** In infrastructure P3s, significant time is spent defining and designing much of the project during the procurement, conforming to what would be needed over the lifespan of the asset, and what the defining functional requirements are, which are often more output-based (e.g., quality standards, availability metrics, etc.) than input-based (prescriptive designs, processes, etc.).[4] Even if the public agency still wants to leverage the creativity and expertise of the developer, this level of project definition theoretically **may decrease infrastructure P3s' "needs" for flexibility.** On the other hand, infrastructure P3s flexibility is only as robust as its ability to handle scenarios that were not predefined as discussed. How these scenarios are handled can impact the cooperative behavior of the public and developers, which is an important factor in project success. Box 2 explores this with a real-world example of the Eagle commuter rail P3 in Denver, Colorado.

[2] These include but are not limited to the costs of hiring of legal, technical, and financial advisors (public agency and developer), preparing a proposal (developer), securing committed financing from lenders/investors (developer), fees to lenders/advisors to obtain committed financing letters (developer), interest costs if debt is raised during the bidding process (developer), providing proposal securities (developer), conducting due diligence on bids (public agency), and running the bid/evaluation process (public agency).

[3] Breakage costs refer to the fees and penalties that may be incurred when an existing financing arrangement or loan agreement is terminated or restructured before its scheduled maturity date.

[4] While this varies between project, during the infrastructure P3 process the design and project scoping carried out at the outset of the project by the public agency—often up to 30%—combined with the design prepared by the bidders—often another 30%—result in almost two-thirds of the project being designed at the end of the procurement process.

BOX 2: FLEXIBILITY IN THE EAGLE P3 INFRASTRUCTURE P3

Eagle P3 (Denver, CO): Infrastructure P3s can be limited by inflexible financial commitments, which may reduce the flexibility of contract terms. Thus, when conflict arises, so too does the incentive to adopt a strict interpretation of the contract, which can lead to a more adversarial partnership. If both parties see contractual language differently, then when it comes to handling unforeseen project challenges, commercial and litigious disputes can arise, as was the case with the Eagle P3 project.

In 2010, Denver Regional Transportation District (RTD) selected Denver Transit Partners (DTP) as a concessionaire to provide new rail transit options along three corridors in Denver, dubbed "Eagle P3", in what would be the first infrastructure P3 for commuter rail in U.S. history. The P3 was designed as a 34 year-long, availability payment contract in which RTD would own the assets, set fare policy, and retain project revenues during the term, in exchange for making periodic payments to DTP based on the availability and performance of the facility.[5]

Challenges with crossing-gate technology, a critical component for rail safety, would end up triggering a three-year review from federal and state regulators, substantially delaying the project. During this regulatory review period, DTP was required to post crossing attendants at 29 intersections that the passenger trains had to cross in both directions for every hour of every day for nearly three and a half years. This would cost DTP more than $111 million.[6]

Disagreement over who bore responsibility for the delay costs culminated in a series of back-and-forth lawsuits with the RTD seeking project termination after DTP sought to recoup its costs. Both parties' claims were eventually denied by a judge after a 2020 trial, in which it was ruled that DTP held the regulatory risk.[7] DTP appealed the judge's rulings, to no success.[8] Notwithstanding the lawsuits, the Eagle P3 project will continue to operate—a testament to the resilience of P3s, but also a cautionary tale about handling unforeseen circumstances.

Photo credit: Balfour Beatty

[5] See: https://www.cpr.org/2018/11/13/a-line-contractor-wants-80m-from-rtd-over-flaggers-withheld-payments/

[6] See: https://wp-cpr.s3.amazonaws.com/uploads/2023/02/RTD-DTP-ruling.pdf

[7] See: https://www.transittalent.com/articles/index.cfm?story=Denver_RTD_Ruling_2-13-2023

[8] See: https://www.partnershipsbulletin.com/article/1872632/denvers-appeals-court-backs-eagle-rail-ruling

3. TOD P3S REQUIRE FLEXIBILITY

As we have stated, TOD P3s are generally more flexible due to their open-ended project scope and the uncertain market they navigate. They are more flexible because they are designed around the fact that one cannot predict what is needed or what the market will look like years from now. For example, a developer may not want to lock-in the design or financing details for a parcel slated for a later development phase **because future market conditions may affect the parcel's specifications, price, or even demand.** Consider the importance of flexibility as it pertains to office space, as evolving norms of remote and hybrid work continue to increase office vacancy rates. To be sure, once a project's scope becomes crystallized and financing is underwritten and then sold to investors, TOD P3s face similar restrictions to flexibility as fully committed infrastructure P3s.

One of the key benefits of a TOD structure with regards to project flexibility is the ability of **the public agency to allow for adjustments** to when and how they receive compensation from the developer. For example, ground lease payments can be delayed until environmental issues or entitlements are settled, guaranteed rent can be exchanged for participating rent, or public asset construction can be exchanged for rent (in-kind payment). Because TOD P3s allow for both parties to develop a common project vision over time, t**here are more opportunities for feedback,** which in turn means both sides can also learn what is most valuable to the other and make financial and scope delivery adjustments in response—which also opens the door to creativity. This is not necessarily the case with respect to infrastructure P3s, in which the public agency knows exactly what it wants from the outset and both parties have determined what is "most valuable to them" by the time the project agreement is executed.

Entitlement risk, which is more acute in TOD P3s, mandates flexibility. In addition to weathering market volatility, navigating the entitlement process—e.g., securing zoning variances and permits—can be an equally uncertain factor that can decide the fate of TOD P3s. This process is usually out of the control of the public agency and occurs after the public agency selects a preferred bidder. Compare this to infrastructure P3s, in which this process typically occurs in the pre-procurement phase.[9] During this process, everybody—neighbors, the community groups, the special interests, etc.—has a voice in front of the zoning board or city council on use requirements, density, affordable housing, or any other public policy goal. All of these factors can affect a development, and as such, requires flexibility on behalf of both parties.

4. TOD P3S ARE NOT FOCUSED ON PRICE AND SCHEDULE—ENOUGH

The indicative pricing approach of TOD P3s proposals limits price-focused competitive pressure. Submitted bids contain schematic designs with financial proposals without full or near commitment—i.e., a bid is designed to "develop itself" in response to market conditions over the agreement term. As such, a bidder's financial offer does not necessarily reflect the market value(s) of the property(ies) and/or the true cost of developing the project(s), and a truly fair price is therefore not guaranteed in the developer procurement. Because of the lack of fixed terms in TOD P3s' procurement, however, price negotiations are common **after financial close and throughout the project term,** often in response to market changes, which can have mixed effects on fairly pricing the project. It also may be more confusing for the public to understand how developers were selected and how the land sale or ground lease levels were derived. **Flexibility without protections can adversely affect public agency goals in TOD P3s. In theory, because of the flexibility afforded to the developer in TOD P3s,** the developer may delay asset construction for reasons beyond a poor market, which has raised concerns that developers engage in "land banking." This can have adverse effects on the public agency, which often has a material interest in activating the land under master development and suffers an opportunity cost. Furthermore, because TOD P3s tend less to have "termination for convenience" clauses, which give the public agency discretion in terminating TOD P3s for reasons other than a material breach, the public agency may have limited tools to address delayed development.

5. INFRASTRUCTURE P3S IMPROVEMENTS: PDA APPROACHES, OPEN BOOK APPROACHES, AND COLLABORATION APPROACHES

Infrastructure P3s that **cooperatively** shape a project's pricing and technical solution, like TOD P3s, can potentially address these challenges. This observation reflects the growing popularity of the PDA-approach which aims to attract more submissions by allowing bidders to submit proposals **without committing to fixed dates or prices,** thereby reducing their upfront development costs and financial risks.[10]

However, the extent to which PDAs affect competitive pressure remains contentious—as there have been instances in which PDA-styled infrastructure P3s **have not achieved financial close** which may otherwise have been achieved under a hard bid procurement.[11]

---

[9] To be sure, in TOD P3s public agencies can lay much of the groundwork for a successful entitlement process as part of proactive pre-procurement and predevelopment work. This can include building community support, assisting with site assembly, and streamlining approval processes.

[10] A PDA is described in the second article, "TOD and Infrastructure P3s: varieties of Risk Allocation and procurement."

[11] "Unlocking the Power of Progressive P3s", P3 Bulletin. Published June 28, 2023. Accessed via https://www.partnershipsbulletin.com/article/1828012/unlocking-power-progressive-p3s

To remedy this loss of price-focused competition in a PDA-style procurement, the public agency can require the bidder **to demonstrate its ability to ensure competitive pricing** as well as involve independent engineers/estimators to validate costs. Furthermore, they can allow greater reliance on **construction indexes**—such as construction materials or labor—for bid repricing if commodity prices increase beyond a stated threshold.

Creating more **transparency into the impact of codified change order provisions** on project pricing can aid public agency's flexibility. Practitioners suggested TOD P3s may offer a cross-model insight for infrastructure P3s, in which instituting price transparency on both sides via "open book" processes can empower both parties to approach unexpected challenges with more nuanced solutions. Open book processes, which are more common in TOD P3s, encourage price information transparency during the procurement stage, which help both parties agree on pricing and risk allocation. This increased degree of insight into a developer's cost drivers and dynamics during procurement can provide the public agency with more confidence that they are **not being taken advantage of downstream** when faced with a project change, which could have otherwise restricted their ability to be flexible.

While infrastructure P3s are inherently more focused on the contractual allocation of risks and responsibilities, they still benefit from good collaboration. Infrastructure P3s' assets—bridges, toll roads, or public buildings—necessitate highly detailed requirements and certainty in terms of outputs because they focus on delivering essential public services. When procured through a two-step, hard bid procurement process, the scope has typically been defined in great detail, the design may have been developed, and the costs and completion date are fixed. After commercial and financial close, the main focus is to deliver what has been agreed upon. Deviations from what was agreed will be difficult to accommodate for both sides. Because of this, the emphasis on **collaborative processes** is secondary to contractual processes. In practice, however, the most successful infrastructure P3s have exhibited good collaboration, which is between the public agency and the developer, which is an enabling factor in the success of the provision of "high-quality, cost-effective, reliable, and timely service at an affordable price." Several methods include:

- **Partnering sessions and agreements to co-create a partnership vision.** "Partnering sessions" help to create and strengthen formal and informal lines of communication early in project implementation by bringing together relevant members of both parties together to establish a vision of partnership (i.e., joint ambitions, values, expectations for the partnership, teaming approach, and the frequency of meetings) for the entire project term, which can be codified in a partnership agreement. This can be an important means to building a more amicable partnership.
- **Jointly staffed decision-making bodies facilitate cooperation.** In addition to partnering sessions, structured "public-private committees" and "joint project offices" can be utilized after the selection of a preferred bidder. These bodies can facilitate frequent and open communication by helping identify and resolve issues before they trigger dispute resolution mechanisms. Examples include a 1) "works committee" during construction, 2) "transition committee" between construction and the operational phase, 3) an "oversight committee" during the operations, and 4) a project management team, of which can be staffed with team members from both the public and private partner.
- **Tiered dispute resolution mechanisms to preempt larger conflict.** By defining tiered systems of problem identification and resolving them through dialogue, dispute resolution mechanisms encourage the resolution of problems at the lowest levels, instead of mediation or arbitration, which can increase confidence of developers and provide clarity for the public agency, thereby boosting collaboration.[13]

BOX 3: COLLABORATION IN INFRASTRUCTURE P3S

Fostering Collaboration Beyond Contractual Processes – The U.S. Department of Transportation's "Successful Practices for P3s" report[12] ", co-drafted by Rebel staff members, to describe how government agencies can best work with the private sector to deliver transportation facilities that protect the public interest" via infrastructure P3s by identifying "successful practices and the important issues they address". Among these important issues is a good relationship

[12] "Successful Practices for P3s" U.S. Department of Transportation. Published March 2016.

[13] Because dispute resolution mechanisms are highly detailed in the infrastructure P3s' project agreements at the point of commercial and financial close, both parties maintain a clearly defined collaborative baseline.

6. BUILD TOD P3S' PRICING AND SCHEDULING GUARDRAILS

Public agencies can build some guardrails to foster greater pricing focus and scheduling certainty in TOD P3s. For one, when developers prepare proposals for a TOD project, the parameters they work with are highly prescribed by the market rental rates, zoning limits, local construction costs, and the financial terms of the lenders and investors. Not that there is not variation and creativity employed in developing a real estate project, **but many of the inputs and parameters are very transparent** since, in many markets, there are abundant comparable projects. This is good for price discovery and, armed with good data, public agencies can feel more confident that they are getting "market" pricing when they negotiate ground lease payments with a developer years after that developer has been chosen in an open competition. Furthermore, **appraisals from licensed appraisers,** while not perfect, provide additional comfort that transaction prices are reasonable. Finally, public agencies can require land pricing upfront and agree to an indexing mechanism whereby sale prices or lease payments are readjusted at take down.

Second, TOD P3s can potentially incorporate **completion date-certainty for specific components,** such as the initial phase or project of a multi-phase/project development. Or a public agency can simply require that the developer "take down" and develop property parcels according to a schedule or forfeit the right to develop those parcels.

Third, if the first phase or parcel of multi-phased/multi-parcel TOD P3s can be fully defined, much like in infrastructure P3s, **then more price-focused competition** can be stimulated by demanding commitments to certain financial terms in this phase, whereas the pricing and lease terms for future phases can be agreed upon later.

7. CONCLUSIONS

While these stylized models and archetypes are subject to many exceptions, infrastructure P3s and TOD P3s suffer certain deficits which can diminish project outcomes. Where infrastructure P3s can adopt more of **PDA, "open book", and collaborative approaches,** they can overcome some of the challenges of the hard bid committed procurement and contracting process. This should make them more agile for current times.

Where TOD P3s can develop more **fulsome mechanisms to focus procurements on price and schedule certainty,** this can help overcome some oft-heard public criticisms that developers ignore the public interest and land bank. By spending time preparing a **master plan and going through the entitlement process ahead of a TOD P3 procurement,** this can greatly increase the likelihood of a successful TOD.

Questions, comments, or new ideas?

Contact us!



SASHA PAGE
Sasha.page@rebelgroup.com | +1 301-675-3102

CHRISTIAN GABLE
Christian.gable@rebelgroup.com | +1 334-488-5579

MARINA SMALLING
Marina.smalling@rebelgroup.com | +1 512-739-2449

REBEL