

The Tools We Need to Measure the Real Value of P3s

A lot of deals never get off the ground because they appear to be too expensive. But we're not looking at them the right way.

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It's no surprise that public-private partnerships (P3s) are a hot topic in the United States. Non-traditional approaches to infrastructure financing promise to help fiscally strapped state and local governments increase investment in public infrastructure, something everyone wants to happen.

But how exactly do P3s make good on this promise? Despite popular perceptions, P3s aren't all about (or even mostly about) lowering construction costs and increasing operational efficiency. The really unique value of P3 arrangements arises from the way they can transfer a specific project funding risk, such as revenue volatility, from local taxpayers to private-sector investors who can bear such risk more efficiently.

"Less fiscal risk, more public infrastructure" is a compelling story. But despite the obvious need for much more investment in public infrastructure, intense interest among public-sector officials, and a huge amount of available private-sector capital, the development and adoption of P3s in the United States has been far slower than expected. Why?

The common theme of failed deals is not hard to find: sticker shock. Risk-transferring P3 transactions *appear* to be expensive compared to traditional alternatives, which erodes support and makes otherwise-surmountable issues fatal. But it is not substantively correct in many cases. It is actually a problem of measurement. If P3s are to fulfill their promise, we need better tools for measuring the value of what they are expected to deliver.

Risk-transferring P3s appear expensive because the existing ways of describing and evaluating infrastructure financing alternatives (such as the classic "[value for money](#)" analysis) focus on expected project-level costs but generally fail to adequately measure the value of funding risk transfer in the public sector's specific fiscal context.

Such a one-sided analysis is akin to judging an insurance policy by adding up all the expected premium payments but ignoring the policyholder's specific benefits of avoiding costly outcomes, such as personal bankruptcy, when an unexpected event occurs. Looked at this way, an insurance policy will at best appear to be a bad deal -- and at worst an egregious waste of money that calls into question the purpose of the policy in the first place.

Inadequate measures of P3 value also impede risk-transferring product innovation. Despite private-sector infrastructure investors' ability and motivation to develop innovative financing products, new infrastructure risk-sharing techniques won't be pursued without a guide to their specific value to the public sector. This is true even where there is an intuitive understanding that risk transfer will be valuable to fiscally constrained governments.

Measuring the value of infrastructure risk transfer is not easy. It involves probabilistic modelling of uncertain factors and their interactions in both complex infrastructure projects and the public sector's fiscal situation. A lot of data and math is required. But successful precedents in the private sector (most notably in financial portfolio management) show that a probability-based methodology can be the basis for practical and effective tools that could be widely used by real-world decision-makers.

A specialized tool for measuring the value of fiscal risk transfer that is accessible to non-technical users among public-sector decision-makers and stakeholders could directly address the problem that risk-transferring P3 transactions appear unnecessarily costly. With such a tool in place, the focus of P3 proposal development and evaluation would shift to optimizing the (now measurable) value of risk transfer for fiscally constrained governments, leading to faster product innovation, better deal-success ratios and higher levels of investment in public infrastructure.

Such a specialized tool for P3 risk transfer doesn't exist -- but it could. There's already powerful off-the-shelf software, abundant fiscal data for U.S. state and local governments, and skillful and motivated people on all sides of the P3 equation. The tool should be designed first and foremost to protect the public sector from bad deals -- and to do this in a way that is clear and transparent to a broad range of stakeholders. But it also must

ensure that genuinely valuable P3 proposals get a fair hearing.

Given the scale of the challenge of improving America's public infrastructure, developing better ways to correctly evaluate all of the public sector's options is clearly worth the effort. Measurement of P3 value should be part of the solution, not the problem.

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