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Client Alert

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Private Financing of Public Infrastructure in North Carolina

In a move that may have long-term implications for construction firms that work on public infrastructure projects, North Carolina Governor Bev Perdue recently announced a new financing model for building such projects in the transportation sector. Specifically, Governor Perdue's plan allows partial private financing for the construction of the final section of the Charlotte Outer Loop, I-485. The financing plan introduces an innovative way to finance these projects in North Carolina.

In recent years, 23 states – North Carolina among them – have enacted legislation permitting transportation officials to enter into innovative financing arrangements with private sector businesses. States are increasingly looking to these public-private partnerships to close the gap between scarce allocations of tax revenues and pressing infrastructure needs. In February 2010, for example, Florida began I-595 roadway construction in what may be the most comprehensive transportation infrastructure public-private partnership in the country. In a deal struck with a construction consortium led by Madrid-based Actividades de Construcción & Servicios SA, Florida will pay almost $1.8 billion over 35 years for the group to design, build, finance, operate and maintain three new toll lanes near Fort Lauderdale.

North Carolina's I-485 project involves a comparatively modest $50 million in private financing (out of a project cost of $340 million). Requests for Proposal (RFP) for the project called on interested bidders to commit to "loan" to the project approximately $50 million in construction funding. As originally proposed, the state would repay the approximately $50 million in installments over a 10-year period, with the final payment coming more than five years after the projected completion of construction.

The novelty of this public-private partnership financing approach was enough to raise an initial challenge by the State Treasurer. Expressing the desire to protect the state's AAA debt rating, the State Treasurer questioned the legal authority of the North Carolina Department of Transportation's (NCDOT) to incur debt on behalf of the state without explicit authorization.

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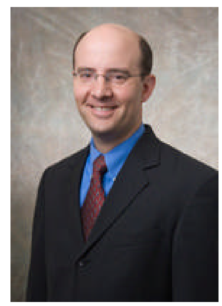

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In January 2010, however, the North Carolina Attorney General's Office issued an advisory opinion that the public-private financing arrangement was constitutional and authorized by statute. Specifically, Chief Deputy Attorney General Grayson Kelley pointed to a 2006 statute, codified as N.C. Gen. Stat. § 136-18(39), which expanded NCDOT's contracting authority. The statute authorizes NCDOT to enter into agreements with private entities "to finance, by tolls, contracts, and other financing methods authorized by law, the cost of acquiring, constructing, equipping, maintaining, and operating transportation infrastructure in this State." The opinion states that the Office of the Attorney General was unable to identify any provision of North Carolina law that would prohibit the proposed financing arrangement for the project.

Expressing disagreement with the Attorney General opinion, the Treasurer has asked lawmakers to review and clarify the issue when they return for the 2010 session, which begins in May. Subsequently, several state legislators have expressed support of the new financing model, including Rep. Nelson Cole (D-Rockingham), the chief sponsor of the statute in question (i.e., N.C. Gen. Stat. § 136-18(39)). NCDOT is moving forward with the financing plan and is proceeding with the RFP and contract award process.

NCDOT has used a design-build model on more than 30 road construction contracts, but the I-485 project will be its first use of the design-build-finance model. In the traditional model, contracts are awarded separately for design and construction of a highway, and those steps occur sequentially. In the design-build model, one contract is awarded to a single company or joint venture that combines both the design of the project and its construction, allowing the design-build contractor or joint venturer to take innovative approaches, leverage efficiencies, and potentially save time and money. In the design-build-finance model, the contractor also puts up all or a portion of the project cost, usually through bank financing.

Given North Carolina's continuing budget challenges and the endorsement of the Attorney General, the I-485 project may become a trend for public infrastructure financing in North Carolina. North Carolina has similar statutes permitting private financing of school and prison projects (N.C. Gen. Stat. §§ 115C-531/532 and N.C. Gen. Stat. § 148-37). The private financing model for school projects under North Carolina's applicable statute has not been utilized much to date because the cost savings projected have been less than expected. Absent further action by the General Assembly, the relevant sections governing school financing are set to be repealed effective July 2011.

In some other states, variations of the public-private financing model for road construction have been controversial. Texas, for instance, instituted a two-year moratorium in 2007 on design-build-finance contracts that allowed the private builder to collect tolls. When the moratorium was lifted in 2009, Texas awarded a $1.02 billion design-build contract funded entirely with public funds. In a similar vein, efforts to turn over the operation and maintenance of, and tolls on, the Pennsylvania Turnpike to a private firm failed in 2007. North Carolina has avoided this type of controversy thus far by maintaining state control over the collection of tolls. The statute authorizing expanded modes of financing, N.C. Gen. Stat. § 136-18(39), may be interpreted to allow for the use of tolls to pay private construction firms, but this financing model has not been tested in either the political arena or the courts in North Carolina, and it has not been proposed by NCDOT to date.

Familiarity with the developing law in this area is important to the success of interested contractors and potential design-build (or design-build-finance) team members. Smith Anderson's construction law, government contracting, and banking and finance groups have closely followed these developments and are prepared to continue to work with clients on public-private partnerships and related issues.

Special thanks to Smith Anderson Attorney Francisco Benzoni,
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