

# **Bond Case Briefs**

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## **Public-Private Partnerships: When Will Reality Meet the Promise?**

The promise of public-private partnerships (P3s) seems irresistible. The \$4.5-trillion that the American Society of Civil Engineers says the U.S. must spend on at-risk infrastructure by 2025 is a backlog beyond the collective means of local, state and federal governments to fund and deliver.

Eyeing both need and return, the private sector is fast developing the required financing and capability, with U.S. and global investment funds looking for placement in physical assets. Dedicated infrastructure funds are raising hundreds of billions of dollars, sourced from pension and sovereign wealth funds and other investors “craving stable returns,” said Bloomberg in a report last month.

Such funds had assets under management that totalled \$450 billion at the end of 2017, up from just \$7 billion in 2000, according to data provider Preqin.

But capital invested in infrastructure has lagged this year as investment deals dropped, says Pitchbook, which tracks them.

More than halfway through 2018, there have been just 19 transactions in the sector worth about \$7.6 billion compared to last year, when investors completed 94 deals totalling about \$36.6 billion, Pitchbook says.

Most investment is not channeled to U.S public infrastructure most in need, says Bloomberg, contending that assets already in private hands, such as electric utilities, gas pipelines and cell towers, are the biggest beneficiaries.

While 36 states have legislation that enables P3 projects, there have only been five P3 greenfield deals in 2017, mainly in transportation. according to Inframation Group, the London-based on line infrastructure finance analysis provider.

New Jersey is set to boost the numbers with Gov. Phil Murphy signing a bipartisan bill on Aug. 15 that broadens P3 investments beyond colleges and universities to other infrastructure including some statewide road projects. But other public owners remain reticent. Baltimore officials voted Aug. 6 to add to November ballots a measure that would make the city the first in the U.S. to amend its charter to preserve public ownership and control over its water and sewer systems and the largest to ban any sale or lease.

What’s stopping the world’s leading economy from becoming the world’s biggest P3 market?

There are many barriers, but risk, both technical and commercial, is the main one. Many funds see it as risky to invest in greenfield projects under a complex legal and regulatory framework. Significant differences in requirements between jurisdictions result in high bid costs and high bars for market entry.

The lack of concerted federal action has not helped. While President Donald Trump’s infrastructure

program, once touted as a \$1-trillion investment, would depend on outside private investment, the effort that might have included partial matching funds as state and local project incentives, has fallen to back-burner status until well into next year.

DJ Gribbin, the former Trump Administration infrastructure advisor who recently joined private equity firm Stonepeak Partners LP as a partner, said governments need to find ways to make it easier for the private sector to invest.

Public sector owners need to provide globally reasonable terms and streamline both regulations and the bidding process to attract private sector participants. Like their counterparts in Australia, they should be open to unsolicited proposals from private sector investors.

If the private entities will own or operate the asset for the long term, they should have incentive to create designs and outcomes that go beyond the brief and create additional benefits for the bidder—and for the wider community. Even under more traditional bidding arrangements, participants should be encouraged to move beyond conforming to a reference design by seeking added value through innovation.

The concept of ‘asset recycling’ offers another way to reduce risk and free up capital for governments to invest in a greenfield development. Using this approach, a government entity develops a project using design and build input from the private sector. When the asset is completed and/or operating, it is leased to the private sector over a longer tax-effective term.

Proceeds from the lease (perhaps 50 to 100 years paid in one installment) then fund the next wave of infrastructure projects. If the re-investment is close to the recycled asset, it can reduce taxpayer concern over the loss of public asset ownership.

Clear communication is key to success. Long-term leases of ports in New South Wales, Australia, have enabled the state government to invest in significant road and rail transportation projects near those ports.

But asset recycling needs a very critical element. By developing the project, the government assumes risk in the construction phase and some of the early stage demand. Past toll road projects in Australia placed this risk onto the private sector, which relied on self-developed traffic forecasts, with the wider road network economics outside proponents’ control.

In a number of cases, this approach overestimated user demand for the new infrastructure and generated major pressure on the financiers, not to mention headline-grabbing lawsuits. Since P3 projects require the goodwill of private entities, risk allocation must be equitable and provide incentives for all parties to meet their obligations.

Maintaining transparency and simplicity is essential—not only for ethical reasons, but also to change assumptions and reallocate risk before the project fails. Project complexity could further shrink by separating contracts into specific delivery packages.

On a passenger rail project, hard-build infrastructure such as track foundations and stations can be split from signal technology systems and from customer service and maintenance operations to enable different companies to focus on what they do best.

While the private sector tends to provide greater service efficiency, communities have higher expectations for P3 projects and are likely to pounce on profit-making entities for any shortcomings or disruption in delivery. So it is important to acknowledge that infrastructure projects are not just financial instruments, but a way to support social and economic activities.

The business case for the project and the community engagement process should take into account those outcomes across the long-term.

Singapore relies on P3 to deliver water treatment and desalination infrastructure, growing the local industry into a global supplier of water technologies, with exports contributing more than \$1 billion annually to the country's GDP. If each of the 50 states develops one P3 project annually, what industries would spring up as a result?

Municipalities and states understand the stresses their infrastructure is under, and should be given a guiding hand in matching local needs with global investors' demand for infrastructure assets.

If communities understood how they could have new hospitals, schools, bridges or water treatment plants with better service and without additional taxes or user charges that also could boost employment, what would they choose?

## **Engineering News-Record**

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