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Building Public Infrastructure Privately.

Private investment in infrastructure has been popular with Republicans since the Reagan presidency. A commission created by Reagan concluded that public-private partnerships ("P3s") could substantially enhance the efficiency, speed and volume of highway, aviation and water projects while lowering the cost to taxpayers and facility users. In the years since, infrastructure P3s have become an increasingly bipartisan cause, with elected officials, including President Obama, touting the many benefits of private investment. There is even a Congressional Public-Private Partnership Caucus co-chaired by a Republican and a Democrat. Ronald Reagan must be smiling.

Back in the 1980's, many policy wonks, we among them, were certain that private equity and ambitious constructors would finally bring free market dynamism to the notoriously moribund business of municipal bricks and mortar.

It never happened that way.

It was not until 2006 when Chicago leased a highway segment to a private investor for $1.8 billion that politicians began to take P3s more seriously. While former Chicago Mayor Daley's monetization of a roadway was certainly shrewd, it is not what President Obama had in mind when he praised P3s in his State of the Union address. The president was talking about new projects and major upgrades to existing facilities, not large cash-for-control transactions.
P3s are less common in America than in other countries mostly because the federal tax subsidy of state and local government debt is not available to projects in which a private developer has long-term construction and operating responsibility. The interest earned by buyers of municipal bonds is exempt from federal – and often state and local – taxation, while earnings on private purpose bonds are taxed. In most other countries, interest on private and government debt is taxed equally. This puts the private delivery of infrastructure at a disadvantage in financing cost.

Developers are often able to make up for the extra financing cost through innovative design, construction and operating efficiencies, but it is a brutal equation. Equalizing the net cost of debt, on the other hand, would allow the value of those efficiencies to flow to facility users and local taxpayers.

Remember too that there is still a "public" in public-private partnerships. These projects and private involvement will happen only when and where a government wants them. Governments still specify the project's service and safety standards and will usually hold final say over pricing.

The president proposed leveling the financial playing field for private and public infrastructure investment. Specifically, he would create Qualified Public Infrastructure Bonds (QPIBs). QPIBs would resemble existing "private activity bonds," or PABs, which are federally tax-exempt bonds issued by or on behalf of a state or local government for the purpose of attracting private investment for projects with demonstrable public benefit. These bonds are typically revenue bonds backed solely by income from the project itself, and importantly, not taxpayers. The problem with PABs is that the amounts that can be issued in each state and the permissible uses are sharply limited, and interest paid is subject to the Alternative Minimum Tax (AMT). As a result, PABs have contributed only modestly to solving America's infrastructure crisis.

Unlike PABs, the QPIB program will have no expiration date, no limits on the total amount issued, and interest on these bonds will not be subject to the AMT. The Administration's proposal appears to include uses that PABs currently allow, including airports, ports, mass transit, solid waste disposal, roads, sewer as well as water, which is not currently covered.

Fiscal conservatives have been wary of expanding tax-exempt bonds for fear of enabling government-sponsored white elephant projects and for increasing deficits by further eroding the tax base. The "static analysis" traditionally employed by the Congressional Budget Office in scoring legislation might well have projected Obama's proposal to increase the federal deficit. However, with the recent adoption by the House of Representatives of "dynamic scoring," whereby the macroeconomic impacts are considered in addition to simple budget math, QPIBs are likely to be scored positively.

PABs and QPIBs are not free lunches. As with any debt instrument they need to be repaid. User fees (tolls, fares, passenger charges, water fees, etc.) or "availability payments" (payments made by government to a P3 developer contingent upon meeting service quality standards) will always be needed. But the advantages of P3s remain – delivering infrastructure faster, for less money, and with lower risks to taxpayers.

Obama's proposal is politically remarkable but it was also probably inevitable. Being able to get more projects constructed while relieving their creaking general government balance sheets is a very big deal for mayors and governors, regardless of party.

Perhaps the best thing about P3s is not just the new money they bring to our crumbling roads, leaky water systems, and crowded airports but that the private money is motivated to succeed.

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By John Buttarazzi and Steve Steckler

Steckler is chairman of Infrastructure Management Group, Inc. and IMG Rebel LLC. Buttarazzi is associated with IMG Rebel and is on the faculty of Georgetown University's McCourt School of Public Policy where he teaches public-private partnerships.