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3 Ways to Take P3s to the Next Level.

“Blended” models have the potential to bridge some big gaps in infrastructure finance.

Public-private partnerships are the future of public finance. That little sentence can light a fire in the world of public money, which is struggling to find the wherewithal to pay for infrastructure.

For a while now, public-private partnerships (P3s), which let a private entity handle everything from the development and operation of a public project to its financing, have become a standard option to replace roads, bridges, wastewater treatment facilities and other core infrastructure. Recently, there’s been talk of using P3s for the reimagining of such icons as New York’s Penn Station and LaGuardia Airport, Chicago’s “L” train, and the Los Angeles Convention Center.

It has become increasingly clear that P3s are a badly needed alternative to finance projects. One reason: Many states and localities have reached either the end of their political will to take on more debt or their legal limits on borrowing inexpensive, tax-exempt money. Federal law does not permit the use of tax-exempt bonds on a project if more than 10 percent of the money comes from private sources, which is why projects are usually financed with all public money or all private money.

At the same time, there is concern that P3s are giveaways to the private sector. The pushback centers on a contention that many P3s don’t shift enough of the financial, operational and political risks onto the private sector.

Despite the unease, there is widespread agreement that the private sector can add value. This is especially true for project management and operations. Private partners don’t answer directly to a political process. They can deploy new technology, invest in preventive maintenance, rearrange staffing and bring in new expertise, all without asking permission. Many government infrastructure managers would give anything for that kind of speed and flexibility.

So what’s got public finance folks excited about P3s’ future? Recent attempts to blend the public sector’s access to low-cost, tax-exempt financing with the private sector’s expertise and agility. Three emerging strategies are moving in that direction.

One is to bring nonprofit partners into the mix with the goal of allowing private partners to have financial skin in the game so that they are more excited about managing or operating a piece of public infrastructure.

Here’s how this strategy would work: A government and its private partners structure a P3 around a nonprofit corporation. That nonprofit sells tax-exempt municipal bonds to finance most or all of the project, leases the project back to the government and then uses those lease payments to pay off the bonds. Because it’s a nonprofit, it can also take money from private-sector investors and write contracts with private partners to maintain and operate a project.

The National Development Council claims to have pioneered this “American Model” of P3s. Seattle’s South Lake Union and the Riverside County, Calif., Law Building are good recent examples.

A second strategy is to expand the scope of tax-exempt financing. Under federal law a government can use tax-exempt private activity bonds to finance infrastructure that's managed by private operators — airports and water-sewer systems, for example. However, federal law also limits the size and scope of the private activity bond market. Expanding the amount of private activity bonds allowed and the types of projects they can finance would expand these joint benefits.

A third is for governments to grow their role as lenders. States have a variety of infrastructure loan programs for local governments. The federal government does the same through Transportation Infrastructure Finance and Innovation Act loans and similar programs. Under some P3 models, private partners can access these programs and use them as loan guarantees against other investments. This can help to leverage enough private investment to make a P3 pencil out. The Move America Act legislation now pending in Congress seeks to boost these types of loan financing tools.

Right now these "blended" P3 models are just a small part of the infrastructure finance landscape. But they have potential to bridge some big gaps.

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