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The Hidden Risks of P3s.

They are an important part of the infrastructure toolkit, but they can't replace tax-exempt debt.

State and local governments are eager to find ways to address the infrastructure deficit. While both the Obama administration and the incoming Trump White House have promoted a greater use of public-private partnerships (P3s), government officials are well advised to bring rigorous analysis and staff expertise to the negotiating table to avoid costly mistakes and minimize risks for taxpayers.

Recent news coverage highlights the importance of careful analysis. A recent article in the New York Times reported on a long-term deal that Bayonne, N.J., cut with a private equity firm in 2012 to manage the city's water system. While the city got an immediate infusion of investment in its ailing water system, residents have since seen their bills rise by 28 percent. City officials had expected rates to be frozen for four years after an initial bump. The rate freeze did not occur, in part because residents had conserved more water than expected, which reduced the amount of revenue the private-sector partner had negotiated.

And in Virginia, the Washington Post reported that one of the state's top transportation priorities has run into a financial hurdle. The state seeks to expand a tunnel in the notoriously congested Hampton Roads region. The project could be costlier than expected due to a non-compete clause negotiated in a 2011 agreement with Elizabeth River Crossings , a partnership between a Swedish construction company and an Australian finance group. The 58-year agreement stipulates that if ERC's toll revenue falls after the tunnel project is built, the state might be required to make up the difference.

Of course, some P3 projects work out well for both the public and private sector. Can Chen and John Bartle describe the successful Port Miami Tunnel project in a new policy white paper written for the International City/County Management Association (ICMA) and the Government Finance Officers Association (GFOA). The tunnel opened in August 2014 and features a 35-year concession agreement, service-quality standards and milestone payments to the concessionaire during the construction period by the Florida Department of Transportation, in partnership with Miami-Dade County and the city of Miami. The tunnel will be returned to the Florida DOT in 2044.

Clearly, P3 projects can be a good way to leverage advanced technology and innovation in the private sector, and they have the potential to bring greater efficiency to an operation. On the other hand, complete project costs and risks often are not anticipated, and many do not factor in the range of equity issues related to service provision and fees. Some states and localities acknowledge the need for more staff and outside expertise to develop and manage P3s. Recognizing that some P3 projects pose a significant risk to public-sector entities — sometimes for decades — GFOA last year issued an advisory to exercise caution when considering a P3 arrangement.

As useful as public-private-partnerships are, they still represent a small part of the infrastructure investment toolkit in the United States. Tax-exempt municipal bonds top the list, paying for everything from roads and bridges to schools, airports, water and wastewater projects, parks, sidewalks, infrastructure repairs, and public transportation. Between 2003 and 2014, states, counties, cities and other local governments invested $3.5 trillion through municipal bonds, while the federal government provided $1.46 trillion. And tax-exempt bonds are on a path to finance another $2 trillion in infrastructure over the next 10 years. In all, debt financing accounts for 90 percent of state and local capital spending, according to a [2015 ICMA policy paper.]

None of this is to suggest that alternative financing tools shouldn't have a place in the toolkit. It's no secret that our investment in roads, water systems and just about every other critical infrastructure priority has fallen behind in recent years. Having a reliable revenue stream to finance the most pressing projects is essential. But while P3s and other financing tools are welcome additions, they cannot replace the role of municipal bonds in financing public projects.

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