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## **Why the Road to Trump's \$1 Trillion Infrastructure Investment is Marked with Potholes.**

- The \$1 trillion that President Trump wants to invest in U.S. infrastructure by way of public-private partnerships may not be a slam-dunk for investors.
- Amid a patchwork of decaying U.S. roads, bridges, schools and water systems, an increasing share of municipal debt is being devoted to shoring up these structures.
- Yet experts warn that, for a variety of reasons, most infrastructure projects lack the revenue stream and return on equity needed to attract private investors.

For a variety of reasons, the mixed track record of rebuilding projects suggests that the \$1 trillion that President Donald Trump wants to invest in U.S. infrastructure by way of public-private partnerships may not be a slam-dunk for investors.

As several PPPs have demonstrated recently — such as the Chicago Skyway's \$2.83 billion sale in 2015 and Westinghouse Electric's high-profile bankruptcy declaration in March — infrastructure funding can swing from success story to cautionary tale.

Amid a patchwork of decaying U.S. roads, bridges, schools and water systems, an increasing share of municipal debt is being devoted to shoring up these structures. According to data from investment management firm PIMCO, about 58 percent of the outstanding tax-exempt municipal debt in the Barclays Muni IG Index is issued for infrastructure purposes.

Yet experts warn that, for a variety of reasons, most infrastructure projects lack the revenue stream and return on equity needed to attract private investors.

"We see a lot of need for infrastructure investment, but the areas where [it's needed] are not necessarily aligned with what public-private partnerships may target, or with what the state and local governments might be willing to turn over to a private operator," David Hammer, executive vice president and head of municipal bond portfolio management at PIMCO, told CNBC in a recent interview.

In view of past experiences, "it's unlikely that you'd see state and local governments use public-private partnerships to address water and sewer needs," for example, Hammer added.

That's true even for cash-strapped cities like Detroit, whose water and sewer system is one of its more valuable assets — making officials reluctant to fully privatize the system, he added.

To be certain, there's still a healthy appetite for public-private investment for massive projects such as New York's \$4 billion overhaul of a major terminal at LaGuardia Airport. Meanwhile, a more than \$1 billion revamp of John F. Kennedy International's Terminal 8 was considered a success for private investors.

However, Westinghouse's cost overruns for its nuclear power plants show how hard it's become for private entities to ensure an appropriate rate of return when the political or regulatory winds shift

against them. Given the long timetable required to birth such projects, roadblocks can be hard to predict.

“These are often generational projects. The idea is that the requirements surrounding those projects, for the safety of all of us, will change as our knowledge base changes,” said Nick Venditti, a portfolio manager at Thornburg Investment Management.

With the exception of toll roads and some airports — where forecasting traffic patterns and revenue streams can be easier — Venditti doesn’t see the public-private partnership model in municipalities as sustainable over the long term, largely because of how hard it is to project an attractive revenue stream for most infrastructure projects.

George Friedlander, a veteran muni analyst with Court Street Group Research, said that while PPPs don’t have a strong track record as a viable financing method, technology may alter the landscape. “Technology drives the case for getting the whole package designed and having a private entity involved earlier in the game than has been the case historically,” he said.

‘Default rates relatively low’

Meanwhile, a potential wildcard could be the Federal Reserve, which is expected to raise borrowing costs through rate hikes, and tax reform that may dim the benefits of muni bonds, many of which are tax exempt.

PIMCO’s Hammer thinks the risks are fairly low given that the asset class historically outperforms other fixed-income asset classes when the Fed hikes rates. He also argued they’re less risky than corporate debt.

Lower-rated investment grade munis “actually default less frequently than [higher-rated] corporate bonds despite all the headlines of the last five years, with Puerto Rico, Detroit, [and] Jefferson County, Alabama, all going through bankruptcies,” Hammer said, citing data from Moody’s Investors Service.

“The cumulative bankruptcy percentage hasn’t gone up for the asset class, so we still see default rates as relatively low,” he added.

Friedlander noted that rating agencies have made it clear that more states have weakened in credit quality recently, due largely to public pension pressures and slower tax revenue growth. However, the number of actual defaults on rated municipal debt remains low, and he doesn’t expect that to change.

David Bogoslaw, special to CNBC.com

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