## Public-Private Partnerships: A Muni Bond Investor’s Guide

**Also known as P3s, these entities are used to finance projects such as bridge construction, airport expansion, and toll roads.**

A public-private partnership (P3) is generally an arrangement between a government agency and a private corporation that finances a large infrastructure project. P3 projects have come in many shapes and sizes, and in a wide array of sectors such as student housing, toll roads, airport terminals, water & sewer, and city street lighting.

Although P3s are less common in the United States than in the rest of the world, the recent passage of the Infrastructure Investment and Jobs Act provides some incentives for local governments to pursue P3s.1 There may be increasing issuance of P3 bonds that would offer an opportunity for tax-exempt bond investors to finance infrastructure projects and be compensated for the construction and operating risk.

P3 bond deals are typically structured in two categories: revenue risk or availability risk. With revenue-risk projects, after construction, an investor would be paid from the net revenues of the project after operating expenses. So, for example, if the project is a toll road, investors would be taking on the operating risk of that toll road. Revenues would not only need to cover operating and maintenance costs, but also the debt service owed to investors. The P3 operator would then be paid from excess revenue. The I-95 Express Lanes in Virginia are an example of this type of project.

Availability-risk projects are different in that bondholders do not take on the risk of the project generating revenue but instead take on the risk of the assets being utilized properly. A good example of this would be Denver Transit Partners, a joint venture that built three commuter rail lines in the Denver area. The P3 is paid by the authorizer, Regional Transportation District, a Colorado state entity, based on the performance metrics of the rail lines and rail cars. These projects incentivize the private operator to keep the lines and railcars in good condition to maximize compensation.

In all cases, construction risk is passed on to the private entity. This is done typically via a fixed-price, design-build contract that keeps the construction costs to a minimum. Given their lack of expertise with certain types of infrastructure projects, municipalities are incentivized to use P3s to create public savings overall on projects, as well as better consumer experiences. Having an experienced builder and operator is an important investment factor to consider for the success of P3 projects.

**Major P3 Projects**

Large urban areas have typically favored P3 projects. The New York City area has multiple such projects, with the Port Authority of New York and New Jersey being an early adopter of P3 structures in the United States.

One example is the Goethals Bridge. The Port Authority of New York and New Jersey made an agreement with the developer, a joint venture between Macquarie and Kiewit Developments called

NYNJ Link that built a replacement bridge for the Goethals Bridge, which was first opened in 1928. The project was successfully built in 2018, and although it was completed behind schedule, bondholder payments continued to flow during construction, and now, in the operating phase of the concession agreement. Goethals is considered an availability-payment P3 as the Port Authority takes on revenue risk, while NYNJ Link is required to maintain the availability of the bridge.

Other Port Authority P3s include airport terminal projects at LaGuardia and JFK. LaGuardia Airport issued bonds in 2016 to construct a new Terminal B and demolish the old terminal. Construction was completed in July 2022. Revenue for the bonds will be paid from lease payments from airlines including American Airlines, Southwest Airlines, and United Airlines. JFK Terminal 4 issued bonds earlier this year to add gates, construct new lounges, and upgrade self-check-in and flight-info display systems. Delta Air Lines, which is responsible for most of the construction, plans to consolidate all its gates at Terminal 4. Delta lease payments would provide cash flow for debt service payments. For airports in New York, there is strong demand for a finite number of gates. The gates could be easily leased to other parties if any airline is unable to pay its lease.

**A Final Word**

P3 bond projects typically carry more risk than a standard municipality since they aren't backed by a tax base or a wide array of projects. Instead, they have project-specific risk, and it is quite typical for rating agencies to give low investment-grade ratings to the projects initially. This could make P3 bond investments more attractive for investors seeking elevated tax-free income. For example, Goethals was originally issued at BBB- by both Fitch and S&P but has been upgraded to A- and BBB+ over time as construction risk subsided. Municipal bond investment teams with advanced credit research capabilities may be best positioned to identify those P3 credits with the potential to strengthen their credit profiles.

1https://bipartisanpolicy.org/blog/five-reasons-public-private-partnerships-could-see-bi--growth-under-the-bipartisan-infrastructure-bill/

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