

## **US Infrastructure: Challenges, Politics, and Opportunities**

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Despite ongoing reports from analysts about the ailing state of infrastructure in the United States, the US Congress continues to focus more on the federal budget deficit than the infrastructure deficit.

Although securing financing for new infrastructure projects can be a challenge, the recession has created an excellent opportunity to take advantage of historically low interest rates and underutilized construction capacity to invest in critically needed infrastructure upgrades. Because there has been less and less money available from traditional funding sources to meet the ever-growing need, both for new capacity and to repair and upgrade aging facilities, governments at federal, state, and local levels have been reluctant to invest in many new projects and have stalled existing projects. Fortunately, public-private partnerships (PPPs) offer an attractive tool to bridge this gap.

In countries in Europe, Asia, and Latin America, and in Canada, PPPs are an established solution to deliver high quality infrastructure projects. Under contracts between the government and private entities, funding for projects often comes from a combination of government money and private investment. More importantly, innovative risk allocation unlocks value, adds efficiencies, and improves quality of service. The private entities involved are generally responsible for construction, operation and maintenance of the project and receive a certain amount of revenue in return, sufficient to cover operating costs, cost of capital, and a reasonable return to incentivize reliable performance to contractual standards. In this way, the risk for projects is shared between the public and private sectors.

Unlike in the rest of the world, PPPs have not been as widely accepted in the United States. PPPs still remain a somewhat misunderstood mechanism that the public views with skepticism and, as a result, politicians may not be as willing to promote. Further, potential lenders and investors are concerned about pursuit costs and the high degree of political risk and uncertainty in the procurement process. In particular, the lack of political will to select PPP projects that are economically viable and to execute concessions after lengthy bid processes makes these projects risky. Even when there has been political support in the procurement process, projects are sometimes cancelled after bids are awarded due to a lack of political will or coordination.

So, the pace of privatization of the infrastructure market in the United States has not reached the level seen in many other countries. Yet, it has been growing in fits and starts. Encouraging the development of PPPs in the United States can be one of the keys to spurring further infrastructure investment and to spending infrastructure dollars more wisely.

The political challenges faced by PPPs exist at all levels of government. Regardless of whether an infrastructure project is at the local or state level, the potential political pitfalls it may encounter are often the same. The public continues to hold misperceptions that PPPs result in selling public assets to foreign companies, excess profits, lack of transparency, diminished environmental protections or a decrease in jobs. While certain areas of the country, such as the states of Virginia, Texas, and Florida, may have a longer history of successfully implementing PPPs as a result of state enabling statutes and bi-partisan support for these partnerships, most states are not in quite so supportive situation, and many lack PPP enabling statutes altogether.

Even aside from state politics, federal policy has been weak in supporting states seeking to use PPPs as a procurement vehicle for infrastructure. Only for certain surface transportation projects does the federal government play a critical role in facilitating PPP transactions, mainly through the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA). Under TIFIA, which is administered by the US Federal Highway Administration in the Department of Transportation (DOT), federal credit assistance in the form of secured loans, loan guarantees, and standby lines of credit is provided to finance surface transportation projects at both national and regional levels.

The purpose of TIFIA is to leverage federal funds to attract co-investment from private and non-federal sources in surface transportation infrastructure projects. Although TIFIA has been instrumental in funding qualified projects that may not have otherwise been able to get off the ground, it is limited in scope. Only transportation, and not other types of infrastructure, falls under its purview, and its capital is limited. The amount of funding available for any particular project is capped at 33 per cent of total project costs.

In order for the federal government to facilitate more infrastructure projects, changes are needed in the current system, and newer programs will likely need to be implemented. In examining the existing system, simple improvements could be made to TIFIA with this goal in mind. For instance, TIFIA could be modified to facilitate longer term planning and staging of projects. Currently, the DOT issues a Notice of Funding Availability (NOFA) each fiscal year to alert applicants as to the estimated amount of funding available for that year. If a multi-year NOFA program were instituted, it would eliminate some of the guesswork involved in estimating which projects may be ready for TIFIA consideration.

Even better, TIFIA could be expanded to include a wider ambit of qualified projects. Proposals from President Obama and Senators John Kerry (Dem-Mass) and Kay Bailey Hutchison (Rep-Texas) would create a self-funding National Infrastructure Bank, modeled somewhat on existing federal loan programs like US Eximbank and TIFIA, to match federal loans with credit-worthy infrastructure projects that are both regionally significant and economically viable. Instead of limiting eligibility to transportation projects, federal assistance would be provided outside DOT for other infrastructure needs, such as water and wastewater systems, flood control and social infrastructure. Similarly, giving funding priority to larger scale, revenue risk, and PPP projects and making these priorities consistent in evaluations of potential projects would increase the pace of infrastructure building.

The federal government through TIFIA today provides not just a source of funding for infrastructure projects but also general expertise in the PPP area. This knowledge is largely wasted and should be compiled and disseminated in a more coherent way. No national center of expertise exists in the United States (compared to, say, Canada or the United Kingdom) to foster PPPs. Because the federal government has the experience of witnessing infrastructure deals made across the country, it is in an ideal position to accumulate best practices. Complete standardization of the types of deals that merit approval based on a “value for money” analysis or other rubric would not be desired. Regional experimentation and innovation are critical. However, at a minimum, identifying best practices and establishing model templates and suggested procedures for state and local governments would streamline the PPP procurement and contacting process and avoid having to reinvent the wheel each time new enabling legislation or a new project at the state or local level is on the table.

Aside from providing expertise on the PPP process in general, the federal government can facilitate the building of infrastructure by stepping up its role in encouraging states to look more seriously at PPPs. While TIFIA has sometimes been the last resort for states that have been unable to secure funding elsewhere for their projects, the statute can be an even more effective tool for bridging the “investment gap” for states. With some expansion of the current provisions of TIFIA, and an increase in its capital, PPPs can become more of a part of institutional knowledge and more widely used to move state infrastructure projects forward by leveraging private capital to lower life cycle costs.

The 2009 economic stimulus package provided needed funding for the nation’s infrastructure, but that “stimulus” is ending. Gasoline tax revenues are falling, while congestion is increasing. Water systems and levies are crumbling, yet there is little consensus on how best to fund infrastructure investments over the long term.

Since 2009, the United States has extended earlier legislation on a short-term, stop-gap basis to continue appropriations for surface transportation projects, but so far has failed to enact a new, long-term transportation authorization bill. Most recently, in September 2011, the House and Senate approved a six-month extension of aviation and highway funding and programs at current levels through March 31, 2012. The US Senate on November 1, 2011, approved further legislation to fund federal transportation programs for 2012, a significantly larger package of transportation funding, yet to be reconciled with the House.

Lack of agreement on a longer term solution hinders long-term planning for needed infrastructure improvements to be funded by federal dollars. In July 2011, the House GOP leadership (including House Transportation & Infrastructure Committee Chairman John Mica (Rep-Fla)) expressed support for future transportation investment only up to the level of Highway Trust Fund revenues, which could result in funding at 30 per cent less than current levels of investment. The Highway Trust Fund depends mainly on fuel taxes and will be insufficient to meet anticipated needs at projected revenue levels. More recently, Chairman Mica has indicated that he and his colleagues may consider a six-year surface transportation reauthorization bill, which would maintain current levels of federal highway and public transportation investment, but there remains no agreement on how to pay for it and no appetite to raise federal gasoline taxes. Nonetheless, this development may be indicative of a bipartisan shift in the House and Senate in favor of greater levels of transportation investment. Still, with 2012 being an election year, progress toward a long term reauthorization bill is caught in the tricky political balance of weighing job creation,

congestion relief, and long term economic growth against fiscal pressures, revenue constraints, and the need for deficit reduction.

On September 8, 2011, President Obama urged the creation of a National Infrastructure Bank and discussed his plans to spend US\$10 billion on infrastructure, such as transportation, water and energy projects, in a speech before Congress. While the planned National Infrastructure Bank originated from the Kerry-Hutchison bipartisan legislation in the Senate, it also has opponents on both sides. Some opponents believe the plan does not devote enough resources to infrastructure projects. Other opponents think supporting state infrastructure banks or adding capacity to TIFIA are better (or at least quicker) solutions than creating a new institution.

Perhaps the most important criterion for predicting PPP success is project selection. In evaluating the type of project that is more suitable for a PPP, as opposed to conventional procurement, there are a few criteria that tend to increase the likelihood of success. Conventional methods of financing to maintain and build essential infrastructure have not kept up with growing demand. The strongest projects typically meet pent-up demand or relieve congestion. Of course, projects with local political support also tend to have higher success rates. Project selection may encompass a variety of other key considerations, including environmental compliance and benefits, network synergies and potential economic return both to investors and the region.

As with projects financed conventionally, PPP projects must comply with all relevant laws, including environmental, land use, zoning, and mitigation requirements. For projects that may cross interstate lines, such as high speed passenger railway systems and interstate highways, environmental clearances may be required at both federal and state levels. State and local governments that develop expertise and carefully target private sector partners with a clear understanding of how the PPP process works are more likely to build successful partnerships. Understanding the necessary ingredients of a successful partnership before entering into one can avoid future problems. In other words, institutional capacity reduces risk.

A key aspect of project selection is attracting potential private investment by considering which projects will have the best chances of an economic return. Private investors in PPPs typically profit by reserving the right to collect revenue or to receive payment from a public agency for the use of an asset. Toll-based systems in congested urban areas, such as the high occupancy toll (HOT) lanes used in Virginia and the SR-91 managed lanes in California, and dynamic tolling both reduce congestion and provide more robust revenue forecasts. In addition to serving as a source of revenue for private investment partners, tolling also allows states with limited resources to expand their capacities to fund other projects.

In evaluating potential economic return, the maturity of the market area in which a project is set to be built, projected economic growth, demographic trends, and available alternatives all matter. Construction of infrastructure in an established, metropolitan market with a stable, diversified economy is the ideal situation for investors seeking a long-term investment. The high volume of traffic or demand in such areas is sufficient to generate a corresponding level of revenue and stable cash flows.

Hand in hand with market maturity, the essentiality of the asset to the area is another factor that may be a good predictor of economic return. Even projects funded by future availability payments from the government rather than tolls should demonstrate essentiality. From a credit perspective, asset essentiality often determines viability as a PPP, whether for transportation, water or social infrastructure. It is for this reason that investors have confidence in essential, recent US PPP projects like the Long Beach Court House, the Capital Beltway managed lanes, and the Port of Miami Access Tunnel.

Regardless of the political climate or how financeable a project may be, the supply of public sector revenue to support the building and maintenance of infrastructure is limited. A more aggressive approach to seeking private sources of capital remains the only realistic way that infrastructure investment can be substantially accelerated these days. Thus, PPPs can supplement, rather than replace, traditional funding sources (like federal grants, tax revenues and tax-exempt bonds) to speed project delivery. Private capital through PPPs brings with it discipline in cost control and project selection based on economic, not purely political, criteria. And the risk allocation PPPs require reduces life cycle costs, increases budgetary certainty, and spurs greater efficiency, transparency and accountability.

Despite the challenges, the US infrastructure market is a growing market with definite opportunities for experienced, creative and tenacious investors. With the aid of greater consistency on a national level to support infrastructure construction, maintenance and development, together with more consistent and widespread state support, a more vibrant and mature market would develop, showing that the use of PPPs can be beneficial for both the public and private sectors.

#### **About the Guest Editor**

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