

Hudson Institute

Infrastructure Spending and Public-Private Partnerships

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March 2017



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I. INTRODUCTION

The Trump administration has rightfully identified repairing our country’s crumbling infrastructure as critical to the economy and job growth. The President, for his part, has proposed an ambitious ten-year, \$1 trillion-dollar program: “We are going to fix our inner cities and rebuild our highways, bridges, tunnels, airports, schools, hospitals.... We’re going to rebuild our infrastructure—which will become, by the way, second to none.”¹

Of course, fixing the nation’s roads, water treatment systems, wastewater treatment systems, schools, waterways, bridges, and transit will require massive investments. The American Society of Civil Engineers estimated in 2013, for example, that the nation would need to spend about \$3.6 trillion on infrastructure by 2020.² By changing how we finance, deliver, and operate infrastructure, we can both unlock billions of dollars of funding capacity and ensure that any new infrastructure we build is more quickly supplied and cost-effectively operated and maintained.

Importantly, low levels of infrastructure spending can have a negative impact on the quality of life for U.S. residents. The Economic Development Research Group, in a report prepared for the American Society of Civil Engineers, estimates that by 2025, the country’s infrastructure funding gap will result in a \$3.9 trillion cost to GDP, \$7 trillion in lost business sales, and 2.5 million lost jobs. The cost to each American family is estimated to be about \$3,400 per year.³ These costs include 6.9 billion vehicle-hours of delay due to road congestion (in 2014) as well as additional costs for congestion at the nation’s airports and port facilities.⁴ Residents and infrastructure users are also keenly aware of their communities’ unique infrastructure needs. Well-known examples include water system repairs in Flint, Michigan; Amtrak’s Portal Bridge over the Hackensack River in New Jersey; the needs of North Carolina’s I-95 corridor; and interstate bridge repair needs in Philadelphia.

Our country’s current inefficient approach to public infrastructure development and operation has made delivery delays, wasteful overhead costs, and stagnant innovation more common. Preventive maintenance and life-cycle asset management, though proven to extend asset life and reduce long-term costs, have become an afterthought.

¹ Donald Trump’s victory speech. Retrieved from <http://www.nytimes.com/2016/11/10/US/politics/trump-speech-transcript.html>.

² *2013 Report Card for America’s Infrastructure*, prepared by the American Society of Civil Engineers, at p. 67. Retrieved from <http://www.infrastructurereportcard.org/a/documents/2013-Report-Card.pdf>.

³ *Failure to Act, Closing the Infrastructure Investment Gap for America’s Economic Future*, prepared for the American Society of Civil Engineers by the Economic Development Research Group, at p. 6.

⁴ *Id.* at p. 13.

With a new Congress and President, we have an opportunity to extract the value that is now trapped in existing assets and to maximize every new dollar. If we do it right, we can usher in a watershed moment in strengthening our country.

II. RESISTANCE IS ON THE HORIZON

While many experts share the President's view that the country has a multi-trillion-dollar infrastructure deficit and that infrastructure spending is critical to the nation's economic vitality, many others worry about costs and efficacy. This split exists in Congress, where congressional Democrats, including House minority leader Nancy Pelosi, appear to favor the President's proposals. According to published reports, however, some House and Senate Republicans are wary of increased spending and tax hikes that could accompany such a large-scale effort. Similarly, other commentators have questioned the merits of public infrastructure investment initiatives. While that opposition appears to focus primarily on *how* we pay for new infrastructure, a few observers also question the fundamental assumption that we need to increase spending in the first place.

We have yet to resolve the longstanding macroeconomic debate over whether publicly funded infrastructure projects have stimulative effects. This paper takes no position on that dispute. And while it supports additional, carefully targeted infrastructure spending, especially on preventive maintenance activity, neither does this paper take a position on how much we should spend. Instead, the paper seeks to offer some granular thoughts about how Congress might encourage infrastructure funding along with a development approach that minimizes the need for new taxes and that others have successfully implemented, in admittedly a piecemeal fashion, in a slew of projects and jurisdictions across the nation.

Infrastructure funding discussions at the federal level sometimes devolve into discussions about the merits of creating a national infrastructure bank, where support for or opposition to the concept can become a proxy for supporting or opposing additional infrastructure spending. While a properly structured, narrowly focused and non-political infrastructure bank could have potential benefits, creating one is not essential to implementing the concepts outlined in this paper.

III. PUBLIC-PRIVATE PARTNERSHIPS AS A CORE STRATEGY

The President and his advisors have appropriately identified public-private partnerships⁵ (P3) as a core strategy for addressing our nation's infrastructure needs. In fact, more than 30 states and the District of Columbia have already enacted statutes that enable some form of P3. Other countries have also embraced P3s as a tool to help cost-effectively

⁵ The World Bank defines a P3 as "a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance." See <http://ppp.worldbank.org/public-private-partnership/overview/what-are-public-private-partnerships>

develop, manage, and replace aging infrastructure. Nurtured through a federal Crown corporation, Canada has a vibrant P3 market that includes projects for roads, water, wastewater, public transit, energy, solid waste management, and even brownfield redevelopment. Similarly, both France and the United Kingdom have decades of experience with the private operation and management of water, wastewater, transit, energy, and airport assets.

While individual goals and strategies may vary, these states and countries are seeking to capture the potential benefits of the P3 model. Those benefits can include lowering construction costs through value engineering strategies, speeding project delivery, accelerating innovation, transferring risk more efficiently, reducing total life cycle costs, improving technology, capturing economies of scale, consolidating procurement, improving performance reporting, and increasing safety, transparency, and accountability.

Many billions of dollars in private capital are in the hands of owners who are eager to deploy it into new revenue-supported infrastructure projects. Such projects could include airports, toll roads, bridges, and water and wastewater assets. When properly implemented, these new P3 projects can deliver high-quality infrastructure assets and services at very competitive prices. There is, however, an enormous need for infrastructure spending that fees won't support, including billions of dollars in deferred maintenance and repairs for curbs, sidewalks, rural roads, and local streets.

As the experience of many public sector innovators shows, elected officials can expand the P3 approach and deploy P3 strategies to reduce the cost of *existing* government operations and assets. Some of these savings arise because a large-scale specialized operator of buildings, roads, airports, harbors, toll roads, water treatment facilities, wastewater treatment plants, or parking systems will often have more access to technology, investment dollars, global best practices, and management know-how than many public agencies would. Using this P3 process for *existing government operations and assets* can create a stream of recurring savings that can be used to fund *new infrastructure projects*. When leveraged at today's historically low interest rates, these savings streams can provide a large "bang for the buck"⁶ when it comes to new infrastructure.

Converting current P3 operating expense savings into tomorrow's capital funding streams would offer still more benefits. In addition to reducing the need for new revenue and taxes to fund today's infrastructure requirements, as the bond payments for the new infrastructure taper off over time, this process will have helped to reduce the run-rate cost of government. Given the massive and growing pension and health care obligations that many state and local governments face, even beyond their unfunded infrastructure needs, operating expense savings are a source of self-generated capital financing that we should not ignore. Also, highly competitive and well-managed P3 transactions, supported by well-crafted contracts and rigorous contract oversight processes, can help ensure that

⁶ Each dollar of savings generated by a P3 of existing operations can support approximately \$12 to \$15 of debt service for new infrastructure.

providers deliver higher levels of service and maintain public assets more efficiently over time—no matter whether the P3s are for new or existing infrastructure. The P3 process unlocks the value trapped in existing government assets and can help boost the value of the operations.

Beginning with one of the nation’s first major wastewater P3s that former Indianapolis Mayor Steve Goldsmith completed in the 1990s—and extending to many subsequent and comparable projects involving a multitude of public assets—private management can often lower operating costs, allowing officials to use those saved dollars for other purposes, including debt service for new infrastructure. A simple example from Mayor Goldsmith’s Indianapolis wastewater project illustrates the point.

Status Quo City Wastewater Operations. Indianapolis owned and operated what people regarded as one of the nation’s best-run tertiary wastewater treatment systems. Revenues generally matched expenses each year, so the operation essentially broke even, generating neither a profit nor a loss.

After a Public-Private Partnership. After a competitive request-for-proposals process, the city entered into a P3 for the long-term operation and maintenance of its tertiary wastewater treatment system. Although consultants had advised that only a 5 percent savings was possible, the private partner, through a combination of lower operating costs and improved revenue collections, managed to save 40 percent, or about \$12 million per year, without raising sewer rates. At today’s interest rates, that \$12 million per year increase in net revenue could support \$144 – \$180 million⁷ in infrastructure spending.

IV. CAN P3S HELP GENERATE \$1 TRILLION FOR U.S. INFRASTRUCTURE?

While it would be faster to have Congress write a check for new infrastructure, using P3s for *existing* operations and assets could also provide billions of dollars for the same purpose without a general tax increase. Again, Indianapolis provides a useful large-city case study.

In 1991, the Indianapolis Chamber of Commerce released a report called “Getting Indianapolis Fit for Tomorrow,” or GIFT for short. GIFT explained that many of the city’s streets, bridges, sidewalks, sewers, parks, and other capital assets had deteriorated and needed immediate attention. The Chamber called upon the city to spend \$1.1 billion over ten years repairing its infrastructure and suggested that the city fund those expenses through a variety of tax and fee increases.⁸ To put that cost in perspective the city’s total annual operating budget was only about \$458 million.

⁷ Assuming a 3.5 percent interest rate, a 30-year term, and debt service coverage ratios of 1.25x to 1.5x.

⁸ See *The Indianapolis Experience*, 1999 at pp. 99-100.

In 1992, after meeting with neighborhood groups, businesses, and other leaders, newly elected Mayor Goldsmith announced the Building Better Neighborhoods (BBN) program, an effort that would be the largest capital improvement initiative in the city's history. It was an ambitious project that would involve hundreds of infrastructure projects and every city department and agency. While a favorable interest-rate environment allowed the city to refinance some existing debt at lower rates, the city funded the BBN program primarily through operating savings generated from dozens of public private partnerships and other public-employee cost savings projects.⁹

Seven years later, the city had spent \$1.3 billion on infrastructure projects, repaving 2,100 lane-miles of roads, repairing 1.6 million feet of curbs and sidewalks, connecting 3,500 homes to sanitary sewers (and taking them off of failing septic systems), improving 141 bridges, and renovating 14 swimming pools and 131 playgrounds. More important, the city completed that infrastructure spending while simultaneously lowering property tax rates four times, reducing the percentage of the city's budget committed to debt service, and increasing public safety funding by \$40 million per year. Indianapolis also became the only large city in the country at that time with a AAA rating from all three major bond-rating agencies. Although not without controversy, BBN focused its spending on the city's seven most distressed neighborhoods based on levels of poverty, crime, and blight.¹⁰

Another byproduct of the city's P3-funded infrastructure efforts was the rapid expansion of minority- and women-owned business contracting. To encourage the use of such businesses, the city had previously updated and streamlined local business regulations, improved its small business outreach programs, and developed a mentor protégé program. In the end, though, the flood of P3 opportunities—and the hundreds of infrastructure projects funded by the resulting savings—drove most of the 2,700 percent and 880 percent increase in minority- and women-owned business contracting, respectively.¹¹

If we extrapolate the Indianapolis experience across the nation on a per capita basis, such an effort could generate up to \$443 billion for new infrastructure projects. While Indianapolis is a large city providing a range of services, smaller cities across the United States could deploy a similar strategy towards a broad swath of government assets and operations. To name just a few: water and wastewater utilities, parking operations (both on-street meters and garages), golf courses, fleet operations, transfer stations, bridges, selected roads, landfills, and airports.

A more recent—and ambitious—example of how public leaders can unlock the value trapped in their existing assets and then use the proceeds to fund other infrastructure needs: former Indiana Governor Mitch Daniels' 75-year lease of the Indiana Toll Road. After a competitive solicitation, Indiana leased its toll road to a consortium of investors for \$3.8 billion dollars in 2005, an amount that, at that time, generated interest at a rate of about \$500,000 *per day*. The state then embarked on Major Moves, a ten-year project

⁹ Id. at pp 9-10.

¹⁰ Id at p. 100.

¹¹ Id. at p. 146.

to enhance Indiana's transportation infrastructure. Ten years into Major Moves, the state had spent \$10.8 billion on construction, preserved nearly half of its roadway miles, and rehabilitated 25 percent of its 1,400 bridges without additional debt or increased costs to taxpayers.¹² During this same period, the private operators of the toll road were required to complete nearly \$600 million in Toll Road improvements, including lane and toll plaza expansions and electronic toll collection.¹³

And it's not just Republican governors and mayors looking at P3 projects. Pennsylvania and Philadelphia have both done so. In 2008, then-Governor Ed Rendell announced that the Commonwealth had accepted a \$12.8-billion proposal to lease the Pennsylvania Turnpike for 75 years. Separately, Philadelphia Mayor Michael Nutter used a competitive request for proposals process to explore the sale of Philadelphia Gas Works. The winning proposal offered \$1.86 billion for the utility. Ultimately, the parties did not consummate either transaction, but it was not for lack of private sector interest, expertise, or resources.

Colleges and universities are also seizing on these same P3 strategies. One of the best-known projects: Ohio State University's long-term parking concession, which generated an up-front payment of \$483 million. The University entered into the transaction as part of a broader strategic effort to monetize assets such as energy infrastructure, golf courses, and real estate. The up-front payment was generated by improving management practices, reducing operating costs, and committing to long-term and mutually agreed-upon parking fee increases. The goal was to help the university produce funds to invest in and support its core mission of teaching, learning, and research.

In the wake of several successful military housing privatization projects, numerous colleges and universities have similarly turned to the private sector to provide capital and management expertise to deliver new and renovated student housing. Examples include the University System of Georgia and Wayne State's four-decade P3 to roll out its \$300 million Housing Plan.

Many billions more in energy-efficient building and facilities improvements could be funded using energy savings performance contracts (ESPC), where local, state, and federal players are already practice leaders.

Even the federal government, through the Department of Housing and Urban Development (HUD), is exploring P3s as a way to deal with repair needs at the nation's Public Housing Agencies (PHAs). With nearly 10,000 public housing units lost each year to disrepair and a \$26 billion maintenance backlog,¹⁴ Congress enacted the Rental Assistance Demonstration (RAD) program in 2012 to improve public housing. RAD, which did not offer new money¹⁵ and which is expected to be revenue neutral for the government, permits PHAs to transfer traditional public housing units from the existing formula funding program to the Section 8 project-based subsidy program. By converting to the Section 8 program, PHAs receive renewable 20-year contracts as opposed to less

¹² See <http://www.in.gov/indot/2407.htm>.

¹³ See https://en.wikipedia.org/wiki/Indiana_Toll_Road.

¹⁴ See <https://portal.hud.gov/hudportal/HUD?src=/RAD/program-details-residents>.

¹⁵ *Why RAD Worked*, by David A. Smith in *Tax Credit Advisor*, August 2015, at p. 20.

reliable annual formula funds. With that funding stability, PHAs can borrow money for repairs and tap into other sources of financing.¹⁶ To date, RAD projects have been able to secure 19-1 leverage. PHAs have used this program for 185,000 apartments—about three times the size of the original pilot program. RAD has been a successful P3 for several reasons:¹⁷

- HUD was committed to RAD’s success;
- RAD unlocked private innovation to produce public goods;
- The program reduced overhead costs associated with government rules and regulations;
- It employs a performance-based model that focuses on what PHAs accomplish, not what they spend;
- It is competitive;
- It bundles design, build, finance, and operations, reducing handoffs among the parties and driving accountability;
- It moves government out of non-core work;
- It puts government where it should be (overseeing outcomes and ensuring equity); and
- It leverages financial equity

Based on the success of the program, HUD is asking that Congress raise its cap of 185,000 public housing units that PHAs can convert.

V. OBJECTIONS AND BARRIERS

Employee Concerns. These P3 strategies for existing government assets and operations are not without risk or downsides. The primary objections tend to come from public employees and their unions, who are concerned about their livelihoods and their futures. These projects need not harm incumbent public employees, however. Well-managed transactions can and generally should commit to no layoff policies for incumbent staff, comparable wages and benefits, and recognition of the employees’ union (if one exists). It is entirely possible to encourage innovation, transfer risk, and unlock additional financial capacity without penalizing incumbent staff or the unions representing them.

¹⁶ See *Rental Assistance Demonstration (RAD) Toolkit #1: Why Rad? A Rental Assistance Demonstration Overview* at <https://portal.hud.gov/hudportal/documents/huddoc?id=Toolkit1WhyRAD.pdf> .

¹⁷ For an excellent discussion of the factors that made the RAD program a success, see *Why RAD Worked*, by David A. Smith in *Tax Credit Advisor*, August 2015, at pp. 20-21. That article, which is essential reading for public sector and P3 reformers, discusses some of the RAD success factors listed below, as well as several others, in more detail.

Can't Public Employees Generate These Cost Savings Themselves—Inside of Government? If the overall objective is to convert recurring operating savings into capital dollars, it's fair to ask why cities can't do that outside of a P3. That is: Why can't elected officials collaborate with incumbent public employees to re-engineer their work and drive the needed savings as opposed to having a private partner do it as part of a P3? Generally speaking, public employees are hard-working, committed to the residents they serve, intimately familiar with their operations, and, consequently, deeply knowledgeable about changes that might generate sizeable, annually recurring savings. Unfortunately, though, they are often trapped in systems that stifle creativity. The sheer, bewildering complexity of otherwise well-intentioned laws and bureaucratic rules designed to reduce waste, fraud, and abuse—regulatory frameworks governing human resources, procurement, and finance—can sometimes impede innovation. And even when officials manage to reduce or remove such barriers, it is still difficult for even the most committed public servant to compete with a private partner that has massive economies of scale, robust research and development capabilities, abundant capital, and the ability to identify and implement global best practices rapidly.

Haven't Some Public-Private Partnerships Failed? To be sure, P3s do not always meet expectations. In fact, several toll road projects in the U.S. have financially struggled in recent years, including Indiana's. Because Indiana received its payment up front and negotiated substantial protections in its P3 contract, the state shielded itself from the impacts of the project's bankruptcy process. In that case, toll road operations continued under new private management.

Most such project disappointments are not due to an inherent flaw in P3s as a strategy, however. Instead, you can usually trace problems to shortfalls in procurement, implementation, or contract management. There are plenty of case studies showing successes and failures in both the public sector and P3s. Trading anecdotes about previous shortfalls doesn't advance the goals of improving services or lowering costs. Energy is better spent on managing operations well, whether they are public or private.

What About Equity, Access, and Quality? Even if the public sector contracts with a private partner to deliver a service or manage an asset using a P3, the public entity remains responsible for ensuring that the service is delivered. That means that public players need to be thoughtful and careful in their approaches to procurement, contracting, and contract oversight. The public sector must always ensure quality, access, and equity in the delivery of public services.

What About Infrastructure Projects that Don't Generate Revenue? As noted above, there is a significant need for infrastructure spending on projects that don't have fees or tolls, including billions of dollars in deferred maintenance and repairs for rural roads and local streets. While cities and states can't use revenue-generating P3s for all projects, they can still be a meaningful part of the overall solution. And, to the extent that P3s for existing operations create additional funding capacity, existing financial resources can be directed towards those projects that lack a revenue stream. For example, in the Ohio State University parking project described above, the proceeds from that transaction could have been used for other non-revenue generating infrastructure projects.

Alternatively, governments may choose to use an availability payment¹⁸ for these types of projects.

Isn't This Approach Political, Anti-Government, or "Republican"? P3s are neither conservative nor liberal, nor are they Democratic or Republican. Their focus is on quality and cost-effectiveness. In fact, some of the leading P3 practitioners nationally are Democratic-led cities and states, the military, HUD, and higher education.

Don't P3s Just Leverage or Borrow Against the Future? There is a legitimate concern that some P3 projects that provide large up-front payments (from asset sales or long-term concession leases) accelerate future revenue streams and leave less money for future needs. To the extent that up-front money is used to fund *current operating* costs, those concerns are even more valid. To address this issue, up-front payments should generally be reserved for funding long-term capital needs or other unique and non-recurring items.

Given the level of disrepair in much of the nation's infrastructure, however, in some cases, using future revenues to complete needed and long-delayed maintenance activity now as opposed to in the future may reduce life-cycle costs over time. Alternatively, leaders can follow the example of former Indianapolis Mayor Greg Ballard: After generating hundreds of millions of dollars in value with a P3 for the city's on-street parking operations, he chose to allow the vast majority of the value to accrue over the 50-year contract term as opposed to taking an even larger up-front payment. Similarly, in the Scranton Sewer Authority project, described below, policy makers chose to allocate much of the P3-created value towards future rate mitigation for the utility's customers.

What About Smaller Cities and Rural Areas? Smaller cities and rural areas likewise have assets and services for which officials can use a P3 strategy to produce operational savings to fund infrastructure spending. The most common assets are water and wastewater utilities, and several successful case studies illustrate the potential.

In 2016, after a competitive solicitation, the Scranton Sewer Authority in eastern Pennsylvania agreed to sell its sewer system to Pennsylvania American Water for \$195 million. The transaction pays off existing utility debt, commits about \$350 million to customer rate reductions over the next 28 years, and provides the system's owners, the City of Scranton and the Borough of Dunmore, with net proceeds of about \$90 million to spend elsewhere. In that project, the acquirer hired all of the incumbent staff at comparable wages and benefits and negotiated a new, multi-year agreement with the employees' union.

Similarly, in 2012 the City of Westfield, Indiana, a 32,066-person community near Indianapolis, sold its water and wastewater assets to the Citizens Energy Group (Citizens),

¹⁸ An availability payment concession involves projects where the private partner receives a periodic "availability" payment from the public partner based on the availability of a facility at the specified performance level. Availability payments can be a viable financing and project delivery model for projects that are not feasible or advisable under a user-fee based concession. See *Availability Payment Concessions Public-Private Partnerships Model Contract Guide*, September 2015, at p. 5 located at <https://www.fhwa.dot.gov/ipd/pdfs/p3/apguide.pdf>.

a local non-profit public charitable trust that serves as the regional gas utility. The \$91 million transaction helped to pay off all of Westfield Utilities' \$45 million debt, reduced user rates from projected levels, and produced a \$46 million payment that the city spent on infrastructure improvements. The acquirer offered all the employees of Westfield Utilities new positions, which enhanced the overall efficiency and customer service provided by Citizens. Along with lower utility costs, ratepayers also benefitted from an additional revenue stream of about \$2 million per year in property taxes paid by Citizens.

What About Loss of “Control?” When properly implemented, a P3 should increase a manager's control. Detailed contracts that outline each party's obligations are essential to well-managed P3 projects. Incentives and penalties can and should be used to drive contractor performance in ways that are much more difficult in a traditional public-sector environment. Moreover, the nation's growing ecosystem of P3 providers, advisors, transactional documents, and management best practices has matured in recent years, and time-tested, industry-wide performance standards are emerging in many service areas as well.

Related to this issue is the involvement of international (i.e., non-American) contractors, providers, and partners in P3 transactions. This issue came to the fore a decade ago when the Bush Administration contemplated allowing Dubai Ports World to manage several U.S. ports. Subject to applicable procurement rules, including reviews by the Committee on Foreign Investment in the United States (CFIUS), these types of concerns can typically be managed as part of the procurement and contracting process (e.g., contractor pre-qualifications, financial and ownership disclosures, CFIUS reviews for national security implications, and bid/bond/insurance/letter of credit requirements and other security guarantees).

VI. SO WHAT'S THE FEDERAL ROLE?

The federal government can take several steps to improve how we finance, deliver and operate infrastructure. These changes would help both to unlock billions of dollars of existing funding capacity and ensure that public entities more quickly deliver and more cost-effectively operate and maintain new infrastructure. Key actions include the following:

- ***Direct federal agencies to facilitate and support high-quality P3 initiatives.*** Federal agencies should survey P3 providers and industry stakeholders and ask them to identify specific federally created barriers to transactions and list those regulations (unrelated to health and safety) that unnecessarily drive up costs or limit innovation. Regulations whose costs exceed their benefits could be modified so that they meet a standard cost-benefit analysis. Sometimes, what seems like a minor burden to a regulator turns out to be a costly requirement to a provider (and, ultimately, to the customer or end user). HUD's RAD Program provides an excellent example of what's possible when a federal agency wants a P3 strategy to work and is prepared to reduce administrative red tape.

When Indianapolis surveyed its minority- and women-owned business community to identify obstacles to doing business with the city, respondents reported that the city's own rules and regulations were one of the largest barriers to their participation in municipal contracting and procurement. Problems included excessive bid and bond requirements, the multiple types and levels of required insurance, the length and complexity of the procurement process, performance standards that were inconsistent with industry norms, and painfully slow payment terms. While each requirement had been thoughtfully put in place to address some previously identified issue or problem, the collective weight of these rules limited competition and drove up prices.

- ***Don't penalize private involvement or investment.*** By providing a cost of capital advantage that allows the use of tax-exempt debt, current tax laws tip the scales toward public ownership of assets and delivery of services. When determining whether a project can use tax-exempt debt, officials should focus on whether the asset or service is a public good, not whether the ownership is public or private or whether a private sector entity or a public sector entity does the work.

Tax-exempt financing, created to allow public authorities access to less expensive debt, carries with it a set of complex requirements that constrain private participation in the production of public goods. Rather than basing the availability of tax-exempt financing on the nature of the use (a public or private road, for example), the tax code looks to the extent of private participation. For example, if a city were to lease its water plant to a private operator that guarantees to reduce operating costs while increasing water quality, the plant could lose access to tax-exempt financing if the lease term exceeded a specific number of years. For too long, some have used the presence of "muni debt" as a shield to operational inefficiency. The remedy is not to extinguish the source of financing, but to extend it to private participation when delivering a public good.

There are also a series of other highly complex tax and regulatory issues that can potentially impact the viability of P3s but are beyond the scope of this paper. They include volume caps for Private Activity Bonds (PABs), the exemption of PABs from the Alternative Minimum Tax (AMT), various IRS Revenue Procedures, the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), equity tax credits (already proposed by the President), and Deemed Dividend Rules for Foreign Capital, among others.

- ***Put your money where your mouth (or bike or car) is.*** The federal government should focus on managing its infrastructure projects and allow states and cities to do the same. Federal bureaucracy often extracts a high overhead cost before distributing funds to states, and rules sometimes prevent money from being effectively allocated. Governments, just like people, make better decisions when spending their money: it's no surprise that we pay for the metaphorical bridge to nowhere with other people's money. The Highway Trust Fund should also be

reformed and modernized, allowing states greater access to federal tax receipts while enabling the Trust Fund to be leveraged for infrastructure finance purposes.

- ***Create a federal capital budget, or at least reform OMB scoring.*** The federal government has no separate budget for capital projects but instead treats operating expenses and capital investments equally. This current budgetary treatment of capital investment can create a bias against capital spending. Deferring capital investment rather than allocating the costs over the lifecycle of the investment has contributed to the crumbling of our infrastructure. Over time, this process has probably increased our capital deficit as well.

Moreover, current budget scoring rules applied by OMB and CBO are tilted against private sector participation, impeding the use of public-private partnerships and other alternative finance and delivery structures for critical infrastructure. These rules, which came about in the early 1990s, reflect now-dated accounting principles. Policy makers could reform them so that the federal government might employ a broader range of policy tools, such as private sector investment, to address the nation's infrastructure problem. Without reform, the deterioration of critical infrastructure, like inland waterways and ports, will unnecessarily penalize taxpayers because a deferred repair will often be substantially more expensive.

- ***Life-cycle asset management.*** We should start funding life-cycle asset management more often, creating incentives for design, build, finance, operate, and maintain (DBFOM) contracts. Current practices that involve multiple handoffs among various parties over the life of an infrastructure asset mean that asset owners cannot hold anyone responsible when they overlook value engineering opportunities or delay maintenance expenses, both of which result in higher long-term costs for taxpayers. Public-private partnerships can help bundle the design, construction, financing, operation and maintenance of a project, aligning incentives across all phases of a project's life to create low-cost, high-quality infrastructure and drive increased accountability.
- ***Explore other strategies to reduce borrowing costs.*** If policy continues to favor lower-cost capital for public projects, an alternative to expanding the use of municipal bonds (suggested above) would be to drive down the cost of private debt for qualifying projects with a tax credit or similar mechanism. The Obama Administration introduced Build America Bonds (BABs) as part of the American Recovery and Reinvestment Act. BABs provided for the issuance of taxable municipal debt by municipalities for a variety of purposes. The interest rates on these taxable bonds were subsidized by the federal government to reduce their cost and bring them more in line with tax-exempt debt. The federal government recovered some of its cost for the subsidies from the increased tax revenues on the taxable interest as compared to tax-exempt debt. As contrasted with BABs, another option is to combine aspects of federal guarantees¹⁹ with taxable municipal debt. Policy makers should model and

¹⁹ This guaranty could be analogous to FHA housing debt or student loans.

analyze a variety of alternatives to identify the approach that scores the most favorably for budget purposes.

- ***Help those who help themselves.*** Consider directing discretionary infrastructure funding to those localities that have voluntarily used P3s or other cost-savings strategies to generate and capture operating savings to fund their infrastructure work. Australia has formally adopted a related approach with its National Asset Recycling Initiative. That effort includes a \$5 billion budget to “provide incentive payments to states and territories that sell assets and reinvest the sale proceeds to fund world-class infrastructure across Australia.”²⁰ Eligible projects can receive up to 15 percent of the price of an asset that an owner sells or leases when the owner reinvests the proceeds in new infrastructure.²¹
- ***Provide technical assistance to those jurisdictions interested in P3s.*** Getting started is often the most challenging part of a P3 project. While there is a robust ecosystem of experienced providers, advisors, and legal counsel, many public officials feel overwhelmed when they begin a P3 program. The opposition can mushroom from incumbent public employees, existing project stakeholders, customers and users, and the media. It takes courage and skill to navigate a project from conception to a decision point, and public leaders need continuing support until they can confidently articulate the tradeoffs of a potential P3 transaction.

One of the most important things the federal government could do is support the implementation of P3 projects by local and state governments. Around the globe, there are dozens of public sector initiated, P3-focused organizations staffed with experienced subject matter experts who are there to assist state and local entities with implementing P3 opportunities.²² While their approaches differ, these offices generally help jurisdictions with project selection, procurement, contract negotiation, legal and financial analysis, and the adoption and replication of best practices. Importantly, these advisors can sometimes serve as a devil’s advocate on projects to help public asset owners avoid common pitfalls and mistakes.²³ One well-regarded entity is Partnerships BC (in British Columbia). In addition to the nuts and bolt of improving project planning and execution, the agency informally promotes projects and seeks to cultivate interest in P3 practices through its website, news releases, publications, and case studies.²⁴

A new Congress and President create a unique opportunity to rethink how we fund and manage the nation’s infrastructure. The policy proposals described above can help public officials to extract value now trapped in existing assets and maximize every new dollar that we spend on improving our infrastructure.

²⁰ *Building Australia’s Infrastructure*, 2014-15 Budget, May 2014, at p. 4.

²¹ *Id.* at p 5.

²² See “Why Isn’t the U.S. Better at Public-Private Partnerships?” by Ryan Holeywell, February 2013, at <http://www.governing.com/topics/finance/gov-public-private-partnerships-in-america.html>.

²³ *Ibid.*

²⁴ See <http://www.partnershipsbc.ca/>

ABOUT THE AUTHOR

Charles “Skip” Stitt is a senior director with Faegre Baker Daniels Consulting where he helps the firm’s public-sector clients devise, implement, and manage innovative reform initiatives to address pressing financial and operational challenges in a wide variety of areas and through a wide variety of means. He has extensive experience with public-private partnerships in particular.

Before joining Faegre Baker Daniels, Skip Stitt spent more than 20 years as a senior-level corporate and public-sector executive and consultant. He began his career as an attorney, focusing on commercial litigation, land-use planning, and administrative law. He then joined the City of Indianapolis for five years as senior deputy mayor and chief operating officer under Mayor Steve Goldsmith, managing the day-to-day operations of a 4,000-person workforce with a more than \$450 million budget. Stitt later founded and led his own firm providing strategic consulting services to cities, states, and public colleges and universities. And he spent nine years in a series of senior positions—including chief administrative officer, public-sector COO, and managing director—at Affiliated Computer Services (now Xerox).

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