Public-private partnerships: A future of opportunities

GOVERNMENT INSIDER | MAY 18, 2017

It's no secret that public infrastructure in the United States is in dire need of investment. The American Society of Civil Engineers' (ASCE) 2017 Infrastructure Report Card gave the state of infrastructure in the United States a grade of D+. The ASCE estimates that close to $4.5 trillion of investment will be needed for infrastructure during the next decade. The ASCE also estimates the total amount of funding allocated for infrastructure systems during that time period is only $2.5 trillion. This leaves an estimated shortfall of $2 trillion - and the question of where the money is going to come from.

The traditional sources of funding for infrastructure, state and federal government budgets, are under increasing pressure from not only shrinking sources of revenue but also ever increasing long-term demands; pensions and other entitlement programs. In particular, as governments borrow increasing amounts to make up for budget shortfalls, questions as to the ability to pay back these government bonds have begun to arise. This has caused the major rating agencies to reduce the credit ratings of government borrowers, thus increasing the costs to borrow, which has then placed the credit worthiness of these governments in further question. It is easy to see how this can turn into a vicious cycle. Illinois, for example, recently had its credit rating reduced to "BBB" – one notch above junk status.

At the same time, in an era of low interest rates and rising asset values, investment professionals are increasingly looking for bankable deals that are able to produce healthy returns on investment over the long term. In 2016 alone, it was estimated that infrastructure funds focused solely on the North American market were sitting on $75 billion in un-invested capital. Clearly, there isn't a lack of available funds; only a lack of marketable deals. With demand on both ends of the deal spectrum, the type of infrastructure assets subject to public-private partnerships (or P3s as they are commonly known) have expanded beyond the traditional toll road concession. Public education facilities, forest preserves, state lotteries, and broadband networks have all been subject to public-private partnerships. Yet, with public-private partnerships encompassing a greater number of infrastructure assets, how does one define public-private partnerships?

WHAT ARE PUBLIC-PRIVATE PARTNERSHIPS?

While there is no single accepted definition of public-private partnerships, a good definition, courtesy of the World Bank, is as follows:

> "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."

This definition is works for a number of reasons.

1. It encompasses both new and existing public assets and services.
2. It includes public-private partnerships in which the private party, or parties, are paid entirely by service users and those in which a government agency makes some or all payments.
3. It encompasses partnerships in many sectors and for many services.
4. It ties all public-private partnerships with a single thread; that the profit of the private party is tied with its performance in the public-private partnership.

However, dig deeper and public-private partnerships can also be described by three broad parameters:

1. The type of asset involved.
2. The functions the private party, or parties, are responsible for.
3. How the private party is paid.

Many public-private partnerships involve new assets, often referred to as greenfield assets. These types of public-private partnerships can involve the financing, construction, and management of a new infrastructure asset. Other public-private partnerships can involve the transfer of responsibility for the upgrade and management of existing assets, often referred to as brownfield assets.

The actual functions the private party in a public-private partnership is responsible for varies from partnership to partnership and can include design, construction or rehabilitation, finance, maintenance, and operations. The private party's responsibility within the public-private partnership can encompass one or several of these functions depending on what the parties actually stipulate in the contract governing the particular public-private partnership.

How the private party is paid is equally diverse. The private party can provide a service to the public and charge the public for that service; often known as user-pays public-private partnerships. The traditional toll road concession is the most common example. The public entity in a public-private partnership can also be the sole source of revenue for the private party. In these government-pays public-private partnerships, payments to the private party by the public entity are often tied to the private party providing the infrastructure asset at pre-defined level of quality. For example, rather than operate a toll road, a public entity can periodically pay to have a public road maintained in a free and open matter by a private party. Of course, in keeping with the fluid nature of public-private partnerships, manner of payment can also be a combination of both user-pays and government-pays.

THE FUTURE OF P3S UNDER PRESIDENT TRUMP

Public private partnerships a future of opportunities

With the ascendency of the Trump administration, there is hope that public-private partnerships will enter into an unprecedented era of growth within the United States. During his campaign, President Donald Trump promised a $1 trillion allocation toward infrastructure improvements. This promise was followed up with a 10-page white paper that stated such an investment would require a $167 billion equity infusion by private investors, and promised a tax credit equal to 82 percent of any equity amount. It's clear that public-private partnerships will play a central role in future infrastructure development. Early in the year, in his address to the joint session of Congress, President Trump reiterated his commitment to infrastructure spending. Furthermore, Transportation Secretary Elaine Chao remarked that the Trump administration may produce an outline of its infrastructure plan soon and there may be legislation later in the year.

President Trump's focus on P3s has been welcome news as these public private partnerships have yet to realize their potential. While 37 states, along with the District of Columbia and Puerto Rico, have legislation enabling some form of P3s, only 18 states and Puerto Rico have ever closed a P3 deal. Texas, New Mexico, and Mississippi have tried unsuccessfully this year to pass their own public-private partnership measures. The reasons commonly cited are that there are not enough public entities willing to engage in private-public partnerships and too many investors questioning the viability of long-term returns.

Resistance against imposing fees on public services and public backlash against the impact of existing P3s, such as the case of the 70-plus year lease of the city of Chicago's parking meters, have made the public entities that engage in public-private partnerships, and the legislators that enable them to do so, hesitant to engage in further P3s. Further, high profile bankruptcies of investor entities engaged in public-private partnerships in states such as Illinois and Indiana have led investors to revaluate their participation in public-private partnerships.

Yet, despite these hesitancies and setbacks, all indicators point to the growth of public-private partnerships. The current state of infrastructure in the United States is quickly becoming untenable. In its 2016 economic study, the ASCE estimated that if serious investment in infrastructure is not made by 2025, the United States risks a $3.9 trillion loss to GDP, $7 trillion in lost business sales, and 2.5 million jobs lost. In addition, the average American family will lose upwards of $3,400 in disposable income each year. In addition, both the United States Chamber of Commerce and the AFL-CIO support robust infrastructure investment.

The bottom line is this: The federal and state governments have found themselves in the eye of a perfect storm of increasing demand and decreasing financial resources. Not only must governments maintain and repair current infrastructure systems, governments must continue to invest in additional capacity to meet the needs of a growing population. As the gap between demand and the ability to meet that demand widens, governments will come under increasing pressure to create a plausible solution; and this is where private investors have a role. Under the right circumstances, private investors can deploy their capital and assist in closing the gap. Governments can provide services to their current and future constituents, and private investors can achieve their desired return on investment. However, to do so, both parties need to be willing to engage the other and compromise.

The creation of independent government agencies dedicated solely to the promotion of public-private partnerships, staffing them with the requisite expertise, and bringing members of the various industries involved into the fold during the creation of the request for proposal (RFP) process can all assist governments in establishing the groundwork for successful and continuous public-private partnerships. A balance must be struck between the provision of high quality public services with the predictability of profitability for the private party. Performance should be tied to profitability to increase the probability of success of public-private partnership. The United States finds itself edging toward the precipice every day significant investment is delayed. Eventually, a significant amount of investment with be needed for both current and future infrastructure; the only question that remains is where that investment will come from.