



Leveraging Federal Funding; Innovative Solutions for Infrastructure
Subcommittee on Transportation and Infrastructure
Committee on Environment and Public Works
U.S. Senate

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May 16, 2017

Thank you, Chairman Inhofe, Ranking Member Cardin, and members of the committee, for inviting me to testify on how the federal government can help build 21st-century infrastructure. It's an honor and a privilege to contribute to this committee's work.

Transportation infrastructure facilitates the efficient production of goods and services and allows families to safely and affordably access jobs, education, and health care, among other services. Unfortunately, public investment has not kept pace with overall needs. As a result, the United States faces a well-documented infrastructure backlog.

Throughout the presidential campaign, Donald Trump repeatedly vowed to spend \$1 trillion to rebuild America's crumbling infrastructure. Unfortunately, this promise has given way to a call for state and local governments to "maximize leverage" through public-private partnerships, or P3s.¹ To facilitate more of these transactions, the campaign released a plan that calls for Congress to authorize a pool of tax credits for equity investors that participate in U.S. infrastructure deals. If enacted, the tax credit plan would leave the vast majority of communities and projects behind while increasing the deficit.

At their core, public-private partnerships are an alternative method of procurement. Importantly, P3s are not a means of closing the infrastructure gap. The binding constraint facing state and local governments is insufficient tax revenue, not a lack of access to financing. Let me say that again. The binding constraint facing state and local governments is insufficient tax revenue. Public-private partnerships and tax credits do not solve this problem. A 2015 report by the U.S. Department of the Treasury clearly states the issue:

All infrastructure investments ultimately depend on either user fees, government tax revenues, or a combination of both. ... Therefore, community and political support for greater investment of government tax revenues or the imposition of user fees is critical to expanding investment in our nation's public infrastructure.²

Instead, the true value of public-private partnerships is risk transference. Unlike traditional design-bid-build procurement models, P3s allow the state to draft a contract that shifts the responsibility for delivering a facility on time and on budget to a private entity. This risk transference does not come cheaply. Private companies rightly demand a premium price for assuming the risks associated with delivering major infrastructure projects. Returns on equity capital often serve as the mechanism by which the private firm secures this premium. The challenge for the public sector is negotiating the appropriate risk-adjusted price. Again, none of these considerations apply if a project sponsor does not have the funding to repay project financing or the political will to face angry constituents unhappy about the prospect of paying tolls or other user fees.



Proponents of P3s often talk about the need to get private capital “off the sidelines.”³ Implicit in these statements is the idea that project sponsors face capital scarcity. This is fundamentally wrong. The municipal bond market is robust with more than \$3.8 trillion in outstanding issuances and a strong appetite for new offerings.⁴ Additionally, the Transportation Infrastructure Finance and Innovation Act (TIFIA) loan program run by the U.S. Department of Transportation offers flexible, low-cost financing that may be tailored to match expected project revenues. The TIFIA program offers credit at a pass-through rate to a treasury security of equivalent maturity. As Treasury notes are considered the global risk-free rate for borrowing, project sponsors are often able to secure financing on terms even more favorable than the municipal bond market.

The current interest rate on a municipal bond with a 30-year maturity and a AAA rating is only 3 percent.⁵ By comparison, equity investors look for annual returns of between 10 percent and 15 percent, depending on the characteristics of the deal. The spread in rates adds up quickly. For instance, the finance charge on \$100 million of municipal debt at 3 percent over 30 years is \$90 million. Over the same period, \$100 million in private equity capital at 15 percent has a finance charge of \$450 million.

The effect of the tax credit plan put forward by the Trump administration would be to lower the cost of equity capital by perhaps 25 percent. Even factoring in this reduction, equity capital is still vastly more expensive than municipal debt. More importantly, there is little indication that investors want tax credits. Equity investors want their capital in deals earning large returns. Receiving 82 cents on the dollar back in the form of a tax credit, as proposed by the Trump administration, undermines the very purpose of investing.

Putting aside the impact of tax credits, public-private partnerships have a very limited applicability. The average total cost of highway P3s with a TIFIA loan and equity capital is \$1.28 billion.⁶ In surface transportation, the potential procurement efficiencies from public-private partnerships are limited to megaprojects. However, the vast bulk of infrastructure needs around the country are smaller maintenance and incremental expansion projects. For example, of the 1,657 highway projects included in Ohio’s Statewide Transportation Improvement Program, only two have a total cost of more than \$1 billion and six a total cost of more than \$200 million.⁷ These projects represent less than half of 1 percent of Ohio’s total. The average project cost is \$9.2 million.⁸

The lesson is that outside of urban mega projects, public-private partnerships have little value. For rural communities, small towns, and economically struggling urban areas, an infrastructure plan based on tax credits is the same as no plan at all.

Investor demand and noncompete clauses

Wall Street is eager to see an expansion of public-private partnerships in the United States. In a 2015 report, UBS summed up the value proposition succinctly: “The high barriers to entry and the monopoly-like characteristics of typical infrastructure assets mean their financial performance should not be as sensitive to the economic cycle as many other asset classes.”⁹

In other words, highways behave like a utility but without price regulations. This characteristic means that a concessionaire—the private firm or consortium that won the P3 bid—can extract monopoly rents from users that are less susceptible to normal business cycles or competition over time. Yet even this is often not sufficient. To defend against future competition, many private firms push for noncompete clauses within their P3 contracts.



These contract provisions are intended to keep a concessionaire financially whole. A noncompete clause often includes a specific list of parallel facilities that the state may not expand or otherwise improve. If the state chooses to make improvements to a listed facility, it must provide a payment to compensate the concessionaire for their estimated lost revenue.

These provisions are troubling on two levels. First, they allow one mayoral or gubernatorial administration to sign a contract that binds the decision-making and investment choices of future administrations for many decades. Second, they offer private firms a degree of guaranteed profitability that exists nowhere else in the marketplace.

Asset recycling

In recent weeks, members of the Trump administration have started pushing the concept of asset recycling.¹⁰ Make no mistake—this is a new term of art for brownfield lease transactions. In a typical lease deal, a state or local government receives an upfront payment from a private concessionaire. In return, the concessionaire obtains the right to collect a stream of user fee revenues over the life of the agreement. These agreements are presented to the public as a source of revenue. In reality, the money the state receives is simply an expensive loan that often comes with contract terms harmful to the public.

For example, in 2008, the city of Chicago leased its parking meters for 75 years in exchange for an upfront payment of \$1.15 billion.¹¹ While this may sound like a significant amount, the payment represented just 20 percent of the city's 2008 budget.¹² And while these funds have all been spent, city residents and planners must live with the terms of this deal for another six and a half decades. Under the terms of the deal, the city is substantially constrained in how it may manage its roadways, including making it more difficult to make improvements to transit service. Although the winning concessionaire has not released its return on investment target, it seems fair to assume that it's substantially higher than interest rates on municipal bonds, which currently stand at 3 percent.¹³ If the city had simply issued debt to generate these funds, residents would face lower parking fees, and the city would have the freedom to grow and change over time without the limitations imposed by this deal.

Similarly, in 2006, the state of Indiana agreed to lease its toll road for 75 years for an upfront payment of \$3.8 billion.¹⁴ After years of travel demand that failed to meet expectations, the concessionaire declared bankruptcy. On the surface, this suggests that the state of Indiana struck an exceptionally good deal since the winning firm clearly overpaid for the toll road. This interpretation misses a more fundamental point. Namely, that neither the state nor the concessionaire had any real idea what future travel demand would be. Both sides essentially guessed and settled on a price that reflected this guess. However, it's not hard to imagine the counterfactual. If the Great Recession had not occurred and travel demand exceeded expectations, then the concessionaire would have walked away with a huge windfall at taxpayers' expense. This begs the question: Do we want our elected officials gambling with public assets? The clear answer is no.

In neither the Chicago parking meter nor the Indiana Toll Road example did the private concessionaire provide any service that could not have been performed through traditional procurement or municipal financing. These deals were cash grabs under the guise of innovation that the public must live with for many decades to come.



Conclusion

There are no shortcuts to rebuilding America's aging infrastructure. The time has come for the federal government to serve as a strong partner by providing direct funding to state and local project sponsors.

These funds should be targeted to those communities facing the greatest need and the highest level of economic hardship. Furthermore, federal funds must address the threats presented by global climate change. Grant recipients should be required to build resilient facilities that account for higher temperatures and the increased threat of flooding and other weather extremes. Finally, Congress should require grant recipients to base their project selection decisions on long-range plans that account for the most up-to-date climate modeling.

Thank you again for the opportunity to address the committee.



Endnotes

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- ⁶ Results based on author’s calculation from U.S. Department of Transportation Federal Highway Administration, “Project Profiles,” available at http://www.fhwa.dot.gov/ipd/project_profiles/ (last accessed May 2017).
- ⁷ Ohio Department of Transportation, “2016-2019 STIP Project List as of 05/11/2017,” available at <https://www.dot.state.oh.us/Divisions/Planning/STIP/Current%20STIP%20Project%20List/Current%20Project%20List%20STIP.xlsx> (last accessed May 2017).
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- ¹¹ City of Chicago Office of Inspector General, “Report of the Inspector General’s Office: Description of City’s Reserved Powers Under the Parking Meter Concession” (2012), available at <http://chicagoinspectorgeneral.org/wp-content/uploads/2012/10/Description-of-Citys-Reserved-Powers-under-the-Parking-Meter-Concession.pdf>.
- ¹² Result based on author’s calculation from Ibid.; The Civic Federation, “City of Chicago FY2008 Proposed Budget: Analysis and Recommendations” (2007), available at <https://www.civicfed.org/file/4866/download?token=2l-MSmk5>.
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