There’s no ‘I’ in team
by Mard Naman

Organizations that strive to build partnerships between public- and private-sector participants are helping drive more infrastructure investment in the United States

During the past couple of years, public sector-sponsored entities have been established in the United States to attract private capital to infrastructure projects, and with public funds often lacking to do the necessary work, the private sector is expected to play a much larger role in upgrading U.S. bridges, roads, water systems and other infrastructure. Yet despite huge needs, deal flow for P3 infrastructure projects has only slowly and incrementally increased in the past few years. But now, 2014 has become the year that the federal government has dramatically stepped up its efforts to get public and private sides together on P3 infrastructure deals. What can investors expect from these developments?
HOW DO THE EXCHANGES RATE?
Among the public-sponsored groups that are coming online, there are the West Coast Infrastructure Exchange, The Chicago Infrastructure Trust and the New York Works Task Force — with more on the way. For example, in June 2014 groundwork was laid to create the Mid-Atlantic Infrastructure Exchange to serve the area around the nation’s capital.

“These entities can serve an important role in developing case studies, standardizing documents and defining best practices in the solicitation, evaluation and execution of P3s,” says Thad Wilson, vice president of M3 Capital Partners. “They can help private investors identify projects by publicizing specifications and connecting investors to public-sector project sponsors. Private investors will require dedicated personnel who are fully aligned with investor objectives to manage the structuring, implementation and long-term oversight of P3 projects.”

With 50 states and seemingly countless city, state and political jurisdictions, Michael Likosky, a P3 expert who extensively advises public officials and institutional investors on infrastructure issues, believes the exchanges present a great opportunity to organize and create project standards in the United States, so deals not only get done but can be replicated from one jurisdiction to another.

Yet for all the publicity and promise the new exchanges have generated, they have accomplished very little so far in terms of real deals. The Chicago Infrastructure Trust, for example, after much fanfare, including public support from former president Bill Clinton, has managed only one small energy efficiency project with $12 million in private investor money. The West Coast Infrastructure Exchange has yet to close a deal. According to Likosky, however, these slow starts are to be expected.

“If you want to do something ambitious, you have to lay a lot of groundwork,” Likosky says. “They hadn’t been working on these institutions before they were created, so you can expect there’s going to be some lag time before they start doing things.”

Part of that groundwork is developing project standards to help provide guidance to both the public and private sides, letting them know what has and has not worked before. The next step for such organizations will be the ability to vet and certify that proposed projects are consistent with those standards.

According to Chris Taylor, executive director of the West Coast Infrastructure Exchange, the idea is to raise the profile of well-conceived projects and help investors identify them. The exchange has not yet initiated this certification process. “There are some important questions — such as what stage of the project the certification should occur — that we need to address before launching this process,” Taylor says.

FEDERAL SUPPORT COMES FROM MANY DIRECTIONS
The creation of regional exchanges provides hope for better deal flow in the future, even if they are off to slow starts. In Washington, D.C., meanwhile, the federal government is finally stepping up as well. Likosky believes the U.S. infrastructure market has been difficult for investors partially because it is so fractured, with seemingly countless cities and states, and countless political jurisdictions. The challenge has been to get the federal government to act with stronger force in support of these projects, and Likosky thinks the United States may finally be turning the corner on that issue.

“The Obama administration has been talking about P3s since day one,” Likosky says. “Now they’re actually doing something about it.” He sees the impact already on the cities and states, which he advises.

First, the Water Resources Reform and Development Act became law in June 2014, which addresses the financing needs for upgrades to drinking and waste water systems, dams, ports and other
water infrastructure. Included in this law is a new low-cost loan program for water infrastructure called WIFIA, short for the Water Infrastructure Finance and Innovation Act. WIFIA is modeled after the successful TIFIA (Transportation Infrastructure Finance and Innovation Act) loan program for transportation projects. Many think WIFIA could be a catalyst for a large number of P3 water infrastructure deals.

Second, over the course of one week in July, Obama signed an executive order launching the Build America Investment Initiative to increase infrastructure investment, and then announced a $10 billion rural infrastructure bank to help jump-start infrastructure projects in farm states and rural areas.

Likosky says the Build America Investment Initiative will do two big things: first, provide technical assistance to cities and states that are not doing many, or any, P3s because they do not know how to do them. It will start with a pilot program for transportation and then add water and communications. Second, it will free up credit within agencies to make sure that credit reaches more intended recipients of P3 support from the federal government. As it stands, TIFIA funds have only gone to seven or eight states. “It has not been used universally,” Likosky notes. He is working with new entrants on building the capacity to go after those funds.

Of the USDA infrastructure initiative, Likosky says, “the Obama administration is committed to looking for and identifying projects for that $10 billion.” Likosky is actively working on packaging these rural projects together for investors. “The challenges are there,” he says, “but we’re readying for conservative-minded investors looking for a solid return.”

Likosky believes the federal government, much more so than in the past, will now actively facilitate and help get projects financed, which he thinks will be very helpful for institutional investors. “The federal government is going to act like a federal government and create one-stop shops for investors and one-stop shops for cities and states,” Likosky says.

As part of this initiative, the administration created the Build America Transportation Investment Center, housed within the Department of Transportation. The center’s mission is to help both private investors and public entities find innovative ways to fund transportation P3 infrastructure projects. This center will serve as the one-stop shop for all P3 participants — state and local governments, public and private developers, and investors — seeking to use public-private financing strategies.

The administration clearly sees this as only the first step, and intends to take the “one-stop shop” idea to other infrastructure sectors as well. At the same time the Build America Investment Initiative was created, President Obama also created the Build America Interagency Working Group. This group’s job is “to expand and increase private investment and collaboration in infrastructure beyond the transportation sector,” according to a White House news release. Chaired by two cabinet secretaries, the group will work with state and local governments, project developers, investors and others to bring down barriers to private investments and partnerships in municipal water, ports, harbors, broadband, the electrical grid and other areas.

**RARE BIPARTISAN SUPPORT COULD SPELL REAL CHANGE**

These federal developments would be less significant without rare bipartisan support. Government gridlock and infighting is arguably among the worst it has ever been in the United States, but furthering infrastructure and P3 projects appears to be one of the very few areas of consensus between the political parties in Congress. “Today, politicians from both sides of the aisle are utilizing
infrastructure as a platform to showcase their support for economic revitalization," says Frank Rapoport, senior partner at Peckar & Abramson and leader of the law firm’s P3 practice group.

More and more, Rapoport says, politicians are referring to newly constructed infrastructure projects, the number of jobs created and the stimulus to the economy generated by modernized schools and courthouses, and improved roads, bridges and tunnels. “Rebuilding America’s infrastructure creates jobs,” is how Rapoport summarizes this new political enthusiasm.

Likosky agrees, and points to a bill awaiting passage right now known as the Delaney Bill. Officially called the Partnership to Build America Act, if passed it will create the American Infrastructure Fund. The AIF will be funded by the sale of $50 billion of infrastructure bonds to provide loans or guarantees to help finance the rebuilding of transportation, energy, communications, water and education infrastructure, using P3s as one of its primary methods.

The Delaney Bill has 39 Republican and 36 Democrat co-sponsors. “That’s unheard of for any other bill,” Likosky says. “The one thing Republicans and Democrats agree on is public-private partnerships. If you survey the country from sea to shining sea, as I do for clients, you see a lot of investable infrastructure opportunities,” Likosky continues. “It’s no longer a question of whether projects are out there; it’s about knowing where to look. And I think we’re going to see a lot more money for infrastructure P3s, from a federal perspective, than we have in the past,” he predicts.

Likosky believes this extends beyond transportation and water to social infrastructure. Social infrastructure P3 projects have attracted controversy, which has made it hard to develop in the United States. “But there is starting to be consensus, both in Congress and in the states, to do social infrastructure. I think we’re going to see a lot more social infrastructure projects,” Likosky explains.

“There’s no reason that the same processes and ideas that have been used for transportation P3 projects couldn’t be expanded to other areas such as water, schools and courthouses,” says Steve Park, an attorney with Ballard Spahr in Philadelphia and an expert on public-private infrastructure financing and legalities. Park says social infrastructure projects are becoming more prevalent. “After the success of the Long Beach Courthouse project, more and more state and local governments are open to using the P3 model as a tool in financing much needed infrastructure,” Park says.

Fred Kessler, an attorney specializing in P3 infrastructure deals for Nossaman LLP in Los Angeles, adds, “Most recently, the City of Indianapolis is pursuing a new justice complex using an availability payment P3 model, and the University of California is pursuing a $1 billion expansion of its Merced campus via a P3 procurement.”

Despite the encouraging signs that the markets for private investment in water and social infrastructure in the United States are poised for growth, to date there remains only a relative trickle of activity, and until more deals are closed, many in the market advise cautious optimism.
The West Coast Infrastructure Exchange is taking steps to educate both public officials and private investors. “There’s a huge awareness gap,” Taylor says. “A lot of unsuccessful deals happened because people didn’t have a clear picture of what they were trying to do and how to get there.”

Taylor is a proponent of the Design-Build-Finance-Maintain (DBFM) approach to P3 deals. In these deals, the private sector is incentivized to design a project that will be lowest cost over its entire life cycle, not just the lowest cost to build. “That’s one of the criteria for a successful P3,” Taylor says. “If it’s all just a cost of capital game, you don’t really need a full DBFM to achieve efficiency. But if there are significant operational costs and risks that can be managed more effectively by private partners, that’s when the model can deliver the most value.”

Taylor says it is wrong to just focus on the building costs. “We shouldn’t be building things we’re not prepared to maintain — that’s part of the reason we’re in the mess we’re in,” he says. “Elected officials decided to build stuff and then didn’t appropriate money to maintain it because it’s much more exciting to cut a ribbon on a new shiny project than do routine maintenance. Then we end up with a huge backlog of deferred maintenance which leads to decaying infrastructure.”

That is one of the key benefits of a long-term DBFM contract: You guarantee that maintenance gets done, because the private side has to meet detailed performance specifications during the operational period. Plus, at the back end of the contract, the private investor has to return the project to the public sector in a good state of repair. “They can’t just blow off the maintenance,” Taylor says.

And if public agencies question how private equity investors can deliver enough value to justify the higher IRR they are seeking, Taylor answers that the private side has to take risks, has to be innovative and has to guarantee outcomes. “To me, that is what can justify paying a higher rate of return for the private capital invested,” Taylor says.

**BUILD A FLOOR, BUT ALSO A CEILING**

The other side of the equation is the public sector can also “de-risk” deals so that the rate of return demanded by private investors does not appear to be outsized. If investors are given a floor return, the investment takes on a fixed income component, in contrast to a toll road deal based entirely on toll revenue projections that could prove completely wrong. Investors in such deals can, and indeed have, lost their entire investments. In that type of arrangement — a private equity deal — investors are going to want a traditional private-equity level of return.

Taylor aims for a middle ground between the two extremes: The real opportunity in the U.S. is for deals that provide some assurance to the investor that they are not going to get wiped out due to circumstances beyond their control, but also assure the public that the investors aren’t going to end up earning a 30 percent IRR “on the back of Grandma Millie,” he says.

Such an approach does commit future government money, whether public priorities 20 years from now have changed or not. But Taylor believes we shouldn’t be building things we’re not prepared to budget to maintain. Numerous studies have found that for every dollar we fail to spend on preventative maintenance, we create a future need for at least $2 of deferred maintenance. “The best analogy is not fixing a leak in the roof of your house,” Taylor says. “The ultimate cost to repair the damage that creates is a multiple of what it would have cost to simply repair the leak when it started. The whole point of this kind of procurement is to lock in costs and incentivize the private sector to minimize those costs because they’re only going to win the bid if their all-in 30-year price is lower,” Taylor adds.
YOU SAY TIFIa, I SAY WIFiA
With new water legislation signed into law, the sector looks poised to become the next big area of P3 infrastructure investments, but that is by no means guaranteed. “The hope is that WIFIA becomes for water what TIFIA has been for transportation,” Ballard Spahr’s Park says. “That said, it’s unclear it will be.” The main reason for this uncertainty is that no one knows yet what types of projects the WIFIA loans will be used for.

It is also unclear what types of borrowers will be lining up for WIFIA loans. “It’s possible that the only borrowers for the loans will be municipal water authorities borrowing money to fix their existing systems,” Park says. That would not be bad, but it would not be the big private investment catalyst that many want it to be. “At this point, we have to wait and see what the guidelines will look like, what the process will be, and who the first few applicants and projects are going to be,” Park concludes.

Nossaman’s Kessler also is cautious. “A problem with WIFIA, unlike TIFIA, is that it bars use of tax-exempt financing, including private activity bonds, if the project uses WIFIA financing,” he says. “We’ll have to see whether projects pencil better using private investment and WIFIA financing or sticking with traditional tax-exempt financing mechanisms, but it would certainly help if Congress allowed both financing tools on the same project just like TIFIA does,” Kessler says.

Others are more optimistic about WIFIA’s promise. According to M3 Capital Partners’ Wilson, because WIFIA is aimed at relatively large water projects, with support limited to 49 percent of the project cost — with the balance required to come from private, taxable sources — the legislation can serve as an important catalyst for private investment in the water sector. He notes that many water and wastewater infrastructure projects are generally carried out at the local level. Therefore, he believes, any effort to increase water infrastructure P3s should seek to enhance the ability of local officials and their staffs to effectively solicit, review and approve such projects.

Indeed, the West Coast Infrastructure Exchange has recently selected water infrastructure to be its main area of focus. “We have been consulting with a working group of experts from the public and private sectors to develop screening criteria for identifying water and wastewater projects that have the potential for aggregation into larger investable structures, such as design-build-finance-maintain or concession agreements,” Taylor says.

FROM P3 TO P4
WIFIA also presents an opportunity for a “P4” structure — with both federal and local government entities included as public partners, Wilson points out, such an approach offers the best of both worlds to municipalities, by combining low-cost federal debt financing with private equity investment that is “at risk” for project performance, while still maintaining ownership at the local level.

“With the efforts of these public sector-sponsored exchanges, combined with low-cost funding and federal support through the WIFIA program, the success of transportation projects should increasingly be expanded into the U.S. water sector,” Wilson concludes.

Likosky concurs. “Water needs are much more spread across the country, so the WIFIA program may have a broader group of users, in terms of cities and states, than does TIFIA,” he says. It should not take long to find out. “I think WIFIA will blossom quickly because there are so many water projects that need to be done,” Likosky says.

But whether those projects will include robust private investment has yet to be determined.

Mard Naman is a freelance writer based in Santa Cruz, Calif.