Speech by
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Thank you Rick.
It's an honor to be asked to speak before your Board of Directors. By definition, you are the most knowledgeable group in America about public-private partnerships?
I've learned much from you this morning. I hope I can tell you something you may not have thought of.
Let me begin with a little history. Ronald Reagan had announced a big privatization push in 1987 and put his own man, Ron Utt, into OMB to make it happen. There were great expectations.
But nobody knew for sure whether PPPs would work. For that matter, hardly anybody called them PPPs. Everything was privatization.

I'll offer you some numbers and observations later, mainly on the water and transportation markets, both of which I've tracked for almost 25 years.
But, first I'd like to set the stage more broadly.
Here's where we were in the late 1980s, early 90s.

Roads
After an epic struggle, financing was arranged for the Dulles Greenway in northern Virginia and SR 91 Express Lanes in Riverside California.
Both projects were done by U.S. developers with the equity and project debt sourced in the U.S.
Rail
What is still the largest PPP ever, Channel tunnel was underway. (Frank McDonough, Goldman Sach, said: “If there was any lingering doubt that the private sector would support a major infrastructure project, this certainly answers that question …)
Privatization trailblazer Ralph Stanley ran Ronald Reagan’s UMTA (now FTA), and was battling the public rail industry to open up opportunities for PPPs.
1989: The first attempt to develop a Florida High Speed Rail system was on track. As proposed by Shearson Lehman, the financing plan amounted to the world’s longest tax-increment financing district.

Airports:
Lockheed—was going to start the ball rolling with a lease of Albany County Airport NY.
The Perot family used its real estate smarts to develop a freight airport in Fort Worth Texas.

Military privatization  (DOD called them “other peoples’ money (OPM)” projects)
Housing, utilities, energy, accommodation facilities. Fort Drum full base. Marching orders were to get it all done quickly.
Federal buildings
GSA, Post Office, Veterans Administration. Washington stopped building in Depression and again in 1960 due to high costs. A new federal building era began in 1988. The plan was to develop almost all new federal offices using OPM in a lease-to-own structure.

Social infrastructure:
Prisons, schools, courthouses, parking garages.

Water
The French water giants were going to take over the entire U.S. water utility business.
Sludge was king.

Well, the megatrend of the future is 1988 is still the megatrend of the future in 2011.
And the reasons why PPPs have not taken off in the U.S. are the same now as they were in the 1980s.
I can’t tell you how many times smart people have told me that infrastructure needs in America are so great, deficits are so dire, and consequences of inaction are so harmful, that the PPP market will take off.
A small contractor from Kentucky wised me up 20 years ago. He had wasted two years trying to put together a PPP on a sewage treatment plant for his very distressed town.
Summing up the experience, he said: “There’s plenty of need, but there’s not enough want in American governments.” He even wondered whether P3s were too hard for municipal governments in the U.S.
Desperate bureaucrats don’t do P3s. They have it thrust upon them by governors and mayors. Procurements can extend beyond their terms in office, however, so political decisions must be made early, the right P3 advisors must be hired and in-house champions identified. Lining up all the planets and getting to the finish line at a time when the capital markets are friendly is the big challenge. Who can do that?

Here’s a fast look at a few P3 markets today:

Airports:
FAA’s Airport Improvement Program appears to be doomed, sooner or later, taking down a lot of infrastructure improvement projects with it. The alternative appears to be Passenger Facility Charges, which cannot be taken away by Washington. PFCs are collected locally and stay local so they can be bonded for local capital projects without projects being federalized.
Airlines now charge $25 for your first bag and $50 for a second. A $5 increase in the PFC at most airports would more than make up for the lost federal funds. I don’t know enough about the aviation P3 business to predict what effect a shift to greater reliance on PFC’s would have. But I do know that when it’s your own money you spend it more wisely. That’s always good for P3s.

Military privatization
Big picture: The military budget has doubled since 9/11. It’s now about $500 billion and that doesn’t include Iraq and Afghanistan, which Brown University says, will total about $3.4 trillion by the time it’s over.
Under the deficit-reduction legislation in effect now, the Pentagon must cut $400 billion over 10 years. If the supercommittee can’t reach a consensus on budget cuts or if it does and Congress doesn’t pass it by Nov. 23, the Pentagon would be hit with mandatory additional cuts of $600 billion more over 10 years.
The Pentagon says that would cause a 1% increase in private sector unemployment, including a flood of soldiers seeking work.
I don’t believe in Armageddon. But something big is happening.
The military housing market is over. Congress is tightening the screws on military housing developers who are seeking relief from overly optimistic forecasts.
Congress is asking a lot of questions about renewable energy contracts, mainly whether it has the money to spend now on future savings that may not be real.

I’m not sure what all this means. But it seems likely that P3 contracts with the military will be less profitable.

**Water**

Each year starting in 1999, I’ve sent a long questionnaire to the largest water outsourcing companies in the U.S. asking about their business. They have generously responded.

Results of the most recent survey, last March, showed water PPPs are a stable but slow-growth market:

The total water utility outsourcing market shared by the six largest contract services firms in 2010 was $1.574 billion. That number represents fees paid by 1,359 municipal clients and 178 industrial owners.

Revenues have been generally flat since 2006 but are trending up now. Municipal O&M revenues are showing the greatest growth—8% last year. Industrial revenues are retreating.

**New business:** Between 1999 and 2010, the largest companies shared 350 new business contracts between them, including capex and O&M. Those contracts were worth $5 billion over the full life of the service agreements, including capex and O&M.

Of those contracts, 24 were for DBO projects worth $1.7 billion in capital and operating fees. That market has been shrinking steadily but could turn around if affordable financing, through private activity bonds, for example, can be added to the value chain.

Industrial O&M revenues are running about $200 million a year, a very small piece of the pie. There is no industrial DBO or DBFO market to speak of.

Each of the major P3 water companies has built considerable O&M, asset management and consulting capabilities. They’ve identified market niches where they can make money. And they all believe in a bright future. Contract renewals typically run above 95%; safety records show P3s to be best-in-class; and I don’t know of any successful prosecutions for clean water violations in the 1,400 municipalities where they operate. On the contrary, P3 companies have cured many hundreds of violations for municipal clients.

Levels of service are dropping among public water purveyors. Because of the diligence and proven performance of P3 operators, I believe the water market is coming their way, and strongly.

**Buildings PPPs**

Like most other markets, the key in the buildings P3 market will be to find ways to do things faster and cheaper. Builders are on a collision course with escalating costs and what their clients think makes economic sense.

There are no new building technologies in the pipeline, so gains must come by wringing inefficiencies out of the contracting process. One target, is misallocation of risk in contracts, which can account for up to 30% of project costs.

That’s the market opening for P3s.

In the public sector, the most recent example is the Long Beach Courthouse in California, a 35-year DBFOM project financed with availability payments over 35 years. If the bureaucrats can get comfortable with the Value for Money analysis on that project, there are hundreds of courthouses, schools and other social infrastructure projects that could be built this way in California and beyond.

**Highway Operations**

Louis Berger started VMS Inc. in 1995 specifically to capitalize on the need for asset management and performance-based for highway maintenance in the U.S.

VMS was awarded the first performance-based highway O&M contract in the U.S. by Virginia DOT in 1997. A handful of other firms jumped in, and Florida, South Carolina and Texas awarded a few contracts. Transfixed Services bought VMS in 2007. All had high expectations, based on the need for their services.

Unfortunately, the market has not developed beyond those early movers and some one-offs in NC, Alaska, and DC.
In contrast: Canada started at about the same time. So far, 28 performance-based contracts have been signed in British Columbia; 23 in Ontario and 8 in Alberta. Taken together, these provinces are signing contracts at a rate of about $300 million a year. The total market is about $3 billion. The whole market will start up again in about seven years when contracts come up for renewal.

**Now to transportation, which is the main subject of PWF.**

The transportation P3 market in the U.S. is mostly about TIFIA.

(Transportation Infrastructure Finance And Innovation Act)

The USDOT’s low-cost TIFIA loans have underpinned every major greenfield P3 project in the past 20 years. TIFIA is the least expensive, most flexible, longest term and most “patient” subordinate debt available in the global financial markets to finance transportation capital expenditures. There is no other financing tool like it in the world.

Without TIFIA, the Goethals Bridge would be a redecking job, a temporary fix causing huge delays and a negative impact on the regional economy. And it would create few jobs.

With TIFIA, the project is the replacement of a dangerous 1920s bridge with an iconic, cable-stayed arch built as a DBFM project that will be privately maintained for 30 years.

So, the future of transportation P3s depends on TIFIA. And TIFIA is wrapped up in the Surface Transportation reauthorization struggle.

Here’s where I think we are on that:

After a handful of short-term extensions, we still don’t know when and whether we’ll get a bill. If House chair John Mica can find new sources of revenue— and he is exploring oil and natural gas revenues—then I think his committee and Senator Boxer’s will find a compromise on the size of the program. And something will happen.

If a multi-year reauthorization bill actually gets done next spring / summer, then TIFIA will likely be a much bigger player.

The consensus is that there will be more funding next year or in 2013—maybe $1 billion a year vs. $120 million now.

A billion-dollar program could leverage $30 in new transportation project starts.

At $120 million, the demand for TIFIA loans greatly outstrips the supply. There are maybe 50 transportation agencies with well-developed projects that have been waiting for TIFIA credit support, some of them for years.

Nobody I talk to thinks there is any chance that Obama’s federal infrastructure bank will get anywhere. (I think there are nine different congressional committees that would have to surrender jurisdiction.) Even if the iBank is created, TIFIA would survive inside it.

So. Best case, it’s $1 billion for TIFIA and maybe five times as many projects starting next year or 2013. Probable case is $124 million a year till after the election and an increase to $1 billion after than. Worst case: TIFIA is identified as a rogue government sponsored enterprise and dies. Another bridge to nowhere.

**Gas tax or tolls?**

Nobody has an answer yet for how to fund our transportation needs, both the backlog and future demands. Some people think we’re past the point of no return.

Congress isn’t helping. The reauthorization process has been so hard because gas tax revenues don’t cover expenses and even maintaining current spending will require someone to find a lot of money somewhere else. For example, Mica’s oil and natural gas levies.

The answer to that question is tied to what happens next November. If the “No-compromise” wing of the Republican Party becomes a majority, then I think the “starve the beast” option will be on the table.
Without any new revenues, federal highway spending from gas taxes alone looks to be headed for a 30% reduction and transit by 50%. Cities will take a big hit. State DOTs are not very good at supporting urban infrastructure. They don’t understand why costs are twice as high as anywhere else. And those costs are unpredictable, hence very risky.

The federal stalemate has already begun to starve the states, obviously.

To try to get projects funded in this environment, you don’t go to the state legislature looking for money. That line goes around the block.

You’ve got to bring a viable plan of finance. These days, if you don’t bring a problem and a solution to the table, then you’re dinner.

One good argument for a gas tax increase goes like this: the federal gas tax runs about $19 per month for the average driver. A 10 cent per gallon increase equals about $4 per month. So, the question gas tax supporters ask is: “will America let its most important public investments crumble rather than pay $4 per month?”

Apparently yes. The last federal gas tax increase was in 1993 and that was a nickel. That nickel is worth about 2 cents today.

I come from New Jersey. Our gas tax hasn’t been raised in 24 years. It was worth 10.5 cents back then and 4 cents now, with inflation. The state’s highway trust fund is broke. New Jersey gets a share of the Port Authority’s recent toll increase and that will help for a while. But, no doubt, the system is broken.

Looking at that record, I tell gas tax supplicants to look up Einstein’s definition of insanity: Doing the same thing over and over again and expecting different results on a gas-tax increase.

What if Einstein isn’t always right, they say? It came up a few weeks ago that Einstein might have been wrong about the speed of light, to mention one example. So if the great Einstein was wrong about that, then perhaps we will get a different result out of this Congress than we did from the previous 18 congresses.

So, if not a gas tax increase, then people talk about a national user-fee system based either on vehicle miles traveled, a distance- based charge, or an aggressive expansion of the toll technology in use today.

If it’s VMT, it will take 10 years before we see a dime.

So it’s tolls. And not just slightly more tolls. Everyone in the highway P3 business wants to toll the Interstates and other national highways.

That would change everything in transportation. It would prove we’re smarter than we look. All of the private capital on the sidelines now and much more would be put into play. It would create an intelligent highway system coast to coast. And it would put millions of people to work on craft labor, bringing substantial wealth to the middle class and tax revenues to Washington.

Ray Lahood’s position? When every governor in America comes crawling to Washington, he'll consider it.

Which brings me to the question: Are we at an inflection point with P3s?

Are we at the point where need finally determines the demand by government for the benefits of P3?

Are the governors and mayors crawling toward Washington? And what will they find when they get there?

Puerto Rico may be a bellwether. I hope Puerto Rico is a bellwether.

First, they’re broke and they know it. So, the new governor passed a comprehensive P3 law a few years ago, put his most trusted agency, the Government Development Bank, in charge, and spent a lot of money to hire the best staff and advisors.

He also guaranteed to contractors that they would be subject to a fixed income tax rate of 10 percent of the net income derived from the project for the full term of the P3.

The Government Development Bank has awarded two projects so far. The first one was the concession of the PR22 toll road. It took 12 months, used legal documents that evolved from three similar projects, and cost the
winner $3 million to bid. It reached financial close last month, paying $1.1 billion to the GDB, which resulted in Puerto Rico’s first debt upgrade in 23 years.

The other current project is for building 100 public schools, which is in the process of being awarded in several procurement packages. The P3 pipeline includes a gas line, new water/wastewater projects, the concession of Puerto Rico’s main airport, provision of new correctional facilities, a 40-km extension of the PR22 toll road and four other toll road projects.

I think there will be many more Puerto Rico's. Almost everybody’s broke. We just haven’t gotten the word down to the troops yet.

Back to the inflection point. Mary Meeker, a famous Morgan Stanley banker, put together a pro forma income statement for the United States last March. It’s frightening.

The U.S. currently has a net worth of negative $44 trillion. Most of the problem is entitlements. Military pensions were the only entitlements in the Civil War era. That grew slowly until the 1930’s and WWII when the federal government began to expand its business lines. The Great Society vastly expanded the federal enterprise.

Current status: GNP grew by 2.7 times since 1965 and entitlements grew by 11.1 times.

Here’s the problem: Mary Meeker says there is an 82% correlation between rising entitlements spending and falling personal savings rates.

People believe they are entitled to more and more services from government, but our huge deficits and negative net worth say to me that most people are not willing or able to pay for those services.

This isn’t new, it’s just getting worse.

There is a huge gap between what we need and what we’re willing to pay for. In the PPP industry, it sometimes results in someone, usually a politician, claiming that P3s are a terrific answer to this huge problem. And then they say: Good bye and good luck.

That’s changing. More and more government officials “get it” and are running procurements that allocate risks in ways that draw in private capital, creativity and long-term diligence. In the transportation PPP market, I would include Puerto Rico, Florida, Alaska, Texas, Colorado, Indiana and Kentucky, to name a few.

So, I believe we are at the inflection point now in the PPP market where governments are really broke and they know it. And they are increasingly willing to entertain PPPs as a compelling option for helping to close the infrastructure gap.

Thank you for listening.