Private Investment in Infrastructure:
New Developments in Washington, DC, and the States

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WHILE THE STATES HAVE TAKEN THE LEAD in promoting private investment in U.S. infrastructure, the U.S. federal government has recently adopted and is in the process of considering several new programs to support increased private investment in the asset class. In this article, we examine the increasing interest in public-private infrastructure partnerships across the United States and consider some of the state and federal actions encouraging these types of partnerships.

These legislative and administrative developments across the country provide welcome opportunities for institutional investors, whose increasing interest in infrastructure is encouraged by a public sector facing aging infrastructure and significant funding needs but lacking the governmental revenues to address these needs. The scale of needed investment is staggering: The American Society of Civil Engineers estimates the five-year infrastructure investment needs of the United States at $2.2 trillion and growing. Yet state and local tax revenues have fallen precipitously during the current economic downturn, with public officials reluctant to raise new sources of revenue from taxpayers and the public increasingly concerned with growing deficits and public spending.

Private investment in infrastructure often takes the form of a transaction called a public-private partnership. Public-private partnership transactions may involve the long-term lease of an existing infrastructure asset by a public owner to a private-sector partner, who is then responsible for the operation and maintenance of the asset. Alternatively, a public-private partnership may involve the construction and long-term operation and maintenance of new infrastructure by a private-sector partner.

U.S. Infrastructure Investment: A Natural Expansion of Traditional Real Estate

In the United States, pension funds and other institutional investors are increasingly taking steps to enter the infrastructure market, hoping to take advantage of projected steady returns over the long run. While infrastructure's profitability may not reach the same levels as other alternative investments, such as commercial real

estate or private equity, it can be solid, often targeting returns ranging between 8% and 15%. In addition, infrastructure investments can be held for the long term, are often protected against inflation, and typically bring lower levels of risk.

Several state pension systems have made significant allocations to infrastructure, with the form of investment differing based on the context. Many state governmental funds have chosen to invest in managed infrastructure funds, while other pension systems have become direct investors in infrastructure projects. In addition to making investments in infrastructure funds and direct investments in infrastructure projects, pension funds and other institutional investors are exploring other methods of investment, such as participating in funds comprised solely of pension fund investors or combined direct investments in which pension funds join in "club" deals making direct investments in specific transactions.

The move by U.S. pension funds into infrastructure is a natural extension from investment in real estate assets. One type of infrastructure asset, public parking, starts out essentially as a real estate asset held by a governmental entity, although the governmental involvement may give it a monopoly or quasi-monopoly position in a specified location (such as an airport) and, therefore, Chicago has been the leader in [providing opportunities for private investment in infrastructure], lease of its ... underground parking garage system, its $1.15 billion street parking

a more stable return. Airports also have hospitality and retail components that are very similar to real estate assets, although again with monopoly positions that may increase their value. Many infrastructure transactions involve the granting of interests in real property, such as the sale of land or a lease or license in real property. Some pension funds include infrastructure investments in the same category as real estate investments, while others have created a unique category. One large retirement system includes both real estate and infrastructure in its "real assets" portfolio, which includes "private real estate debt or equity investment opportunities, public real estate debt or equity, infrastructure, timber, agricultural real estate, oil and gas, real asset mezzanine debt or equity, mortgage-related investments, entity-level investments, real estate investment trusts (REITs), master limited partnerships (MLPs), and other opportunistic investments in real assets."

State and Local Efforts to Promote Private Infrastructure Investing

The seven specific types of infrastructure listed in the investment policies of one large retirement system give a sense of the wide range of asset types that can be swept into this category. The seven are the following:

- Transportation assets (including roads, bridges, and transit facilities)
- Ports (including airports and seaports)
- Utilities (including clean energy, pipelines, and power transmission)
- Water (including water treatment, distribution, and desalination)
- Energy (including gas, geothermal, wind and water generated, and nuclear)
- Communications (including broadcast and wireless towers, cable systems, and satellite networks)
- Social infrastructure (including schools, hospitals, and courthouses)

Most of these infrastructure assets (such as roads, bridges, water systems, airports, schools, and courthouses) typically are publicly owned and are under the jurisdiction of state and local governments. As a result, state and local governments must provide some type of legal authorization for private investment in such assets.

With the tremendous need to identify new and innovative ways to finance projects, state and local governments have increasingly looked to private sources of capital to fund both new and existing infrastructure. Approximately half the states have authorized some type of public-private partnership in infrastructure, either through general authorizing legislation across different sectors of infrastructure or through specific authorization in certain sectors of infrastructure. Public infrastructure traditionally has been financed through the issuance of tax-exempt debt. Since public pension funds are themselves tax-exempt, they have had little incentive to invest in the tax-exempt debt market. As states adopt legislation authorizing transactions involving private investment in infrastructure, public pension funds, and other institutional investors have new opportunities to invest in infrastructure.

One of the earliest states to authorize infrastructure public-private partnerships was Virginia, which adopted its Public-Private Transportation Act in 1995. The Virginia statute covers a broad array of transportation infrastructure, including roads, bridges, ports, airports, parking, and mass transit. It authorizes procurements by governmental bodies for specific transactions as well as unsolicited proposals from the private sector, in each case related to the development of new infrastructure assets or the operation of existing assets. Currently, the $1.4 billion Capital Beltway high-occupancy toll lane project is being developed under the statute.

Within the past year, several additional states (as well as a United States territory) have taken steps to authorize private investment in infrastructure. In February, California enacted a new law focused on the development and rehabilitation of transportation infrastructure through public-private partnerships. The law authorizes the imposition of tolls for both toll roads and separate high-occupancy toll lanes. In addition, projects that do not involve tolls can be carried out under the new law. For example, California is currently considering several projects involving "availability payments" under which the state would pay a private entity that would be responsible for financing, developing, and subsequent to completion, operating and maintaining a road project. The law includes a specific process under which projects are to be approved and then undertaken. In addiwith its $1.8 billion long-term lease of the Chicago Skyway, ... its $563 million long-term concession, and its continuing efforts to enter into a long-term lease related to [Midway Airport].

tion to its new public-private partnership law, California recently enacted a law authorizing development of a new courthouse in Long Beach by a private-sector partner who would finance the project and, following completion, operate and maintain the facility under a long-term contract. This type of private investment in "social infrastructure," including schools and hospitals, as well as government buildings, is particularly common in Canada, Great Britain, and other parts of Europe.

In July, Arizona enacted its own public-private partnership authorization law, covering various forms of transportation infrastructure, including highways, railways, public transit, and intermodal systems.

Other states are taking a more incremental approach to promoting private investment in a broad array of infrastructure projects. New York created the New York State Commission on Asset Maximization to address its mounting infrastructure needs. The commission issued a report in May that focuses on creating a long-term structure for implementing projects involving private investment in infrastructure. The plan would begin primarily with smaller projects focused on rehabilitating existing infrastructure and developing social infrastructure, such as schools and higher education facilities, and would also seek private investment in energy and telecommunications infrastructure in the state. Michigan is following a somewhat similar strategy, creating an Office of Public-Private Partnerships within its Treasury Department, hiring an outside advisor to consult on potential projects involving private investment and considering the adoption of legislation authorizing public-private partnerships.

One of the most expansive new laws authorizing private investment in infrastructure was enacted in June and sets forth Puerto Rico's public policy on public-private partnership transactions. The adoption of the law was one of the first major accomplishments of the new administration of Governor Luis Fortuño. Under the law, governmental entities within Puerto Rico are authorized to enter into transactions involving both new and existing infrastructure assets in a broad range of areas, including water, wastewater, electric power, transport, solid waste, roads and bridges, parking facilities, airports, seaports, mass transit, and communications systems. The government of Puerto Rico is in the process of establishing the new public-private partnership program and is expected to begin launching projects later this year, with an expectation of generating more than $7 billion in investment in Puerto Rico in the next three to five years.

In addition to these actions at the state and territory level, local governments are increasingly providing opportunities for private investment in infrastructure. Many local governments have "home rule" authority that permits them to undertake transactions without the need for separate state-authorizing legislation. Chicago has been the leader in this regard, with its $1.8 billion long-term lease of the Chicago Skyway, the first long-term lease of an existing toll road or toll bridge in the United States, as well as its $563 million long-term lease of its downtown underground parking garage system, its $1.15 billion street parking concession, and its continuing efforts to enter into a long-term lease related to Chicago Midway International Airport. Other local governments are considering similar transactions, such as Los Angeles, which is considering a transaction related to its street parking and parking garages, and Pittsburgh, where the city is considering a parking transaction and the county is considering an airport parking transaction.

The Supporting Role Of the Federal Government

While the states have taken the lead in promoting public-private infrastructure partnerships, the federal government's role has historically been more limited, in part because public infrastructure—such as roads and bridges, airports, ports, parking facilities, and mass transit systems—are typically operated by state and local governments. While the federal government sponsors public-private partnerships of its own in other contexts (one recent example is the federal Public-Private Investment Program [PPIP], which aims to create public-private partnerships related to distressed financial assets), state and local governments typically sponsor public-private partnerships for infrastructure investment, and most such partnerships can be undertaken without federal approval. As a result, federal government involvement in public-private infrastructure transactions is

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often limited to a supporting—but important—role through federal financing programs.

Several existing federal programs provide financial assistance for public-private partnerships in infrastructure. Under federal law, private activity bond financing can be used for certain types of infrastructure projects, including certain road, bridge, and intermodal projects. Private activity bonds are tax-exempt bonds that can be used for projects that involve some level of private finance and operation. By enabling tax-exempt financing, which is typically available only for public projects, to be used for infrastructure projects that include private investment, public-private partnerships benefit from lower capital costs that help leverage additional private investment. The federal government's Transportation Infrastructure Finance and Innovation Act (TIFIA) program provides credit assistance through direct loans, loan guarantees, and standby letters of credit. TIFIA typically finances the most difficult to fund dollars in a public-private partnership project. The limited federal financing assistance that TIFIA provides helps to leverage private investment. For example, in the recently closed I-595 express lanes project in Florida, a $603 million TIFIA loan was coupled with $750 in private bank debt and $200 in equity investment from the private sector to finance a $1.8 billion high-occupancy toll lane project.

While the recently enacted federal stimulus bill, the American Recovery and Reinvestment Act (AARA), provides more than $30 billion for infrastructure projects, most of the projects being funded are smaller-scale projects that will not involve private investment. However, AARA includes authorization of up to $1.5 billion in Transportation Investment Generating Economic Recovery (TIGER) discretionary grants, which will be allocated by the secretary of transportation on a competitive basis for surface transportation infrastructure projects, some of which may involve private investment. In addition, AARA permits $200 million of the TIGER discretionary grants to pay for the subsidy costs of TIFIA financing, which is estimated to support an additional $2 billion in federal credit assistance through TIFIA.

The upcoming surface transportation authorization legislation, which is currently being considered by Congress and would authorize multiyear federal funding for roads, bridges, mass transit, and intermodal facilities, is the next federal initiative that may have a significant impact on private investment in infrastructure. With limited political desire to increase federal gas taxes or impose a vehicle mileage fee on drivers, private investment provides a means of helping finance the nation's infrastructure needs. Proponents of private investment in infrastructure are advocating for the expansion of private activity bonds and of the TIFIA program, as well as for increased federal tolling programs. In addition, the Obama administration and a group of members of Congress have each proposed a National Infrastructure Bank. The administration thus far has proposed a more modest program, with initial funding for a program that would provide grants and credit assistance for transportation projects. The congressional members, led by Rep. Rosa DeLauro of Connecticut, have proposed, in HR 2521, a more sweeping program covering a wide array of infrastructure and proposing to provide $250 billion in subscribed capital, including $25 billion through appropriations of $5 billion each year over five years, as well as authorization for an additional $625 billion in debt financing. The implementation of such a proposal, which is modeled on other government- and quasi-government–sponsored infrastructure banks in other parts of the world, could have a significant impact on helping the United States meet its infrastructure needs by combining governmental financing assistance with private investment.

The convergence of the tremendous need for infrastructure development in the United States, the limited sources of revenue available for infrastructure through traditional methods of finance, the lead that states and local governments have taken to promote private investment in infrastructure, and the possibility of continued and expanded support from the federal government—coupled with the attractiveness of infrastructure as an asset class—indicate that infrastructure will continue to be an important emerging area for investment by pension systems and other institutional investors. ■

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