Reinvesting In Infrastructure Has Benefits For All

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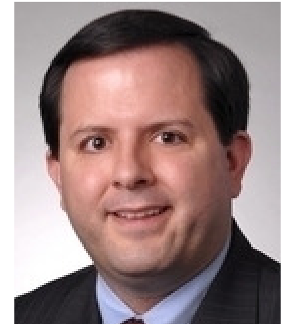

With the impending closing of the Puerto Rico PR-22/PR-5 Toll Roads concession, the commencement of the Puerto Rico San Juan Luis Muñoz Marín International Airport concession procurement process and the adoption of legislation authorizing the initial steps of the Ohio Turnpike concession, renewed interest in existing asset public-private partnerships is developing in the United States. Since 2005, state and local governments in the United States have entered into long-term concessions related to toll roads and bridges, public parking systems and maritime port facilities, and have proposed concession transactions for airports. Various other long-term concessions have been pursued and were not entered into as a result of political opposition and lack of market interest in the proposed transaction terms.

Existing asset public-private partnerships offer numerous benefits to governmental entities and the public in general. Properly structured, these transactions shift long-term operations, maintenance, construction and financing risk to the private sector, allowing the public to benefit from the efficiencies and innovation of private sector operation. At the same time, a well crafted transaction will result in the public sector partner retaining significant oversight and regulatory authority over the private sector partner through the terms of the concession agreement and the incorporation in that agreement of detailed operating standards.

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Of course, in addition to the shift of risk and operating costs to the private sector, the benefits of private sector efficiency and innovation and the retention of regulatory authority by the public partner, existing asset concessions also result in significant payments to the governmental entity involved in the transaction. In different transactions, these payments have come in the form of upfront payments, ongoing payments or revenue share payments or some combination. The allure of a large cash infusion has attracted public officials to existing asset concessions but at the same time galvanized opponents of these transactions who decry them as a sell-off of critical government infrastructure. The focus on the payments from these transactions has obscured the focus on the other value inherent in existing asset public-private partnerships.

The Attraction of P3 Payments

This focus on the payments from existing asset public-private partnerships is natural. Whether as an upfront payment or through the present value of future payments they are large—in some cases the largest upfront payment or payment stream a governmental entity may ever receive in a single transaction. As a result, the use of proceeds demands a clear public policy rationale, backed up if possible by legal constraints that promote that policy. In addition to other benefits, existing asset public-private partnerships allow governmental entities to redeploy capital for other means that can generate investment and long-term returns for the public. This is not unlike a private business that sells a subsidiary and uses the proceeds to reinvest in other operations (except of course, in the public analogue, the public partner not only does not sell the asset but retains regulatory oversight related to it).

In the case of several existing asset transactions already undertaken by state and local governments, transaction proceeds have been reinvested by the public partner. Governor Mitch Daniels used the USD3.8bn in proceeds from the Indiana Toll Road transaction for infrastructure improvements across Indiana, including fully funding the state's ten-year capital program (making Indiana the only state with such a fully funded program) and providing extra funds for counties in the vicinity of the Toll Road. The Maryland Transportation Authority used a USD140m "capital reinvestment payment" from the Seagirt Terminal transaction for other infrastructure in Maryland. The City of Indianapolis is using the proceeds of its parking public-private partnership transaction for other infrastructure projects in the City.

Reinvestment As A Legal Requirement

In each of the above cases, the governmental entity implemented its reinvestment policy with respect to use of proceeds at the time of entering into the concession agreement. In none of the cases was the use of proceeds required by a pre-existing legal mandate. However, legal requirements governing the use of proceeds that are adopted prior to the commencement of procurement, can result in many benefits: reinvestment policies can be mandated; public officials can be less tempted to

use proceeds for operating budget costs and other short-term purposes; the public can have confidence in the long-term benefits of the transaction; and a greater focus can be placed on the other positive aspects of existing asset public-private partnerships.

As a legal matter, it is virtually impossible for a governmental entity to obligate itself, solely by state statute or municipal ordinance, to use existing asset public-private partnership proceeds in a certain manner. In some cases, state constitutions or state laws create trust funds that insulate moneys from diversion for other purposes, but this is often difficult to do and requires a state constitutional amendment or the placement of public funds in a foundation type of structure. A state statute or municipal ordinance imposing general use requirements could always be amended prospectively and proceeds not otherwise obligated can be used for other purposes.

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The diversion of tobacco settlement funds for operating purposes by many states is a good example. In other words, a lock box can usually can be unlocked again by the governmental entity. That being said, the Indiana laws that committed the use of Indiana Toll Road proceeds for infrastructure have not been changed and have instead embodied a political and public consensus about the use of proceeds that has withstood the call of some politicians to use the proceeds for other purposes. Similarly, committing transaction proceeds to a specific infrastructure development project is another method of creating public support and political commitment related to use of proceeds that practically, if not legally, would be difficult to change after the fact.

While a government cannot easily mandate itself to use proceeds for specific purposes, in certain cases state governments can impose such mandates on local governments and the federal government can impose such mandates on state and local governments. When the Illinois General Assembly passed legislation for a property tax exemption necessary for the Midway Airport concession transaction, it included a requirement that at least 90% of transaction proceeds be used for infrastructure or to fund public pensions.

Airport Privatizations

Section 129 of the Title 23 of the United States Code allows for federal aid to certain toll highway, bridge and tunnel projects involving a private operator but requires that all excess funds from the project beyond debt service, operation and maintenance and a reasonable return to the private operator be used only for purposes permitted under Title 23 (i.e., highway and mass transit capital projects). Federal airport revenue diversion requirements mandate that if a public airport were to pursue a long-term concession of its airport parking operation outside of the Airport Privatization Pilot Program, proceeds must be reinvested in the airport.

The federal examples above demonstrate how the federal government can implement policies that encourage existing asset public-private partnerships with a requirement that proceeds from such transactions be reinvested in other infrastructure projects and the Illinois example demonstrates how a state government can implement laws that require reinvestment in infrastructure of existing asset concession proceeds. United States Senator Mark Kirk's proposed Lincoln Legacy Infrastructure Development Act promotes this approach by making clear that the Section 129 provisions described above apply to concessions of existing highways and requiring that excess proceeds from such transactions be used for highway and mass transit purposes.

Federal laws also could be enacted to incentivize existing asset public-private partnerships on the condition that proceeds from such transactions be reinvested in infrastructure. For example, the Transportation Infrastructure Finance and Innovation Act (TIFIA) could be amended to provide that TIFIA federal credit assistance could be used to finance an upfront payment for an existing asset public-private partnership so long as the proceeds are reinvested in infrastructure by the recipient public entity.

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State Infrastructure Banks

The form of reinvestment could include, as well as specific projects, the creation of a state infrastructure bank that could be used to finance additional infrastructure in the state. If a National Infrastructure Bank is created, that bank could provide financing for an existing asset public-private partnership under the same condition. Federal law also could be changed to permit tax-exempt private activity bonds to be used to finance payments for existing asset public-private partnerships under similar terms. This is not dissimilar to the Seagirt transaction in which tax-exempt bonds were used to finance an upfront payment that the Maryland Transportation Authority invested in other infrastructure projects in Maryland.

At the state level, states can enact legislation that condition that proceeds of existing asset public-private partnerships undertaken by state agencies or local governments or special purpose governmental authorities be reinvested in infrastructure projects. In cases where proceeds are otherwise subject to appropriation by the state legislature, such provisions may lead back to the lockbox problem, where a subsequent legislative act related to specific appropriations could effectively undo the earlier requirement to reinvest proceeds in infrastructure.

However, with respect to local governments and special purpose agencies, where the appropriation of project proceeds does not need to return to the state legislature for approval, there is a lesser likelihood that the legislative mandate would later be changed. Similarly, to the extent a state entity provides financing assistance to a project (for example through a state level TIFIA-type program or state infrastructure bank, as has been proposed in several states), that program can be applied to existing asset public-private partnerships with the condition that proceeds be reinvested in infrastructure.

Future Returns

Of course, the reinvestment of proceeds of existing asset public-private partnerships in other infrastructure projects could be accomplished simply as a matter of public policy decisions and not through specific legal constraints. However, to the extent these types of legal requirements are enacted, they help cabin the temptation to use proceeds for other purposes, give the public greater confidence with respect to the transaction being undertaken, reduce the shadow that the use of proceeds question has on the benefits that accrue to the public from the transaction and ensure that proceeds from the transaction will be used for reinvestment in infrastructure that will create significant returns in the long term.

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