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P3 Fact Check:

For Big Infrastructure, is Government Debt Really Cheaper?

Too often, discussions about the financing of today's large or complex infrastructure projects are sidetracked by a debate about the low cost of public debt or credit ratings versus private equity.

How often have you heard, "municipal debt is cheaper than public equity?", therefore alternative project delivery mechanisms that incorporate a private equity component are too expensive?

"It's false comparison," says, Rodney Moss, Regional Managing Director of Aon Risk Solutions. "A debt or credit rating for a government entity is a portfolio rating of the resiliency of their portfolio of assets to take risk; it's basically equivalent to a line of credit. Financing a project is about the cost of the risk associated with constructing and maintaining a public asset—it's the net present value."

The Net Present Value (NPV) or the profitability of a project is the combination of capital cost, operational cost and financing cost. The size of the net present value ball is the same whether it's publicly financed or privately financed or some combination of the two.

NPV BY THE NUMBERS

Fiction: Public-private partnerships are more expensive than municipally funded projects.

Fact: Financing a project is primarily about the cost of the risk associated with building and maintaining an asset – not a government entity's portfolio or credit rating.

To determine the lowest net present value, a public entity must estimate the total capital, operational and financing costs of a proposed asset. Think of the net present value as a ball. To estimate the value of the net present value ball, the entity must calculate the radius. The radius of the net present value ball is made up of the risk-free component of the debt service and the cost of the risk or the cost of the debt to repay that debt.

Moss continues, "So, the cost of risk is the combination of development risk, design and construction risk and lifecycle risk (which includes the debt service). How you allocate risk in each of the three buckets determines how big that net present value ball is and how it should be financed. The smallest volume of the sphere ought to be the one who delivers this project—it's a project equation not a question of credit line."

"Public entities have the same working layer of risk, but the equity sits on their balance sheets—they just don't know what it is or it's not recognized as such," explains Moss. "The operational layer of risk gets absorbed into their operation."

WHO REALLY FUNDS INFRASTRUCTURE?

Fiction: The public perception is that P3 financed projects are funded 100% with equity.

Fact: The equity-funded portion of a P3 is about 20%.

A common misconception about P3 projects is that they are funded entirely with private equity.

“If you look at the complete funding pot of a typical US transport P3 project, often only about 20% to 30% is privately financed,” says Anthony Phillips, with John Laing, an infrastructure investment company. “The rest comes from capital contributions or other forms of supported debt. So, really in that way you are getting access to cheap debt and government supported debt, while the private finance component provides that P3 overlay and rigor in terms of due diligence.”

George Burgess, Chief Operating Officer of Becker & Poliakoff and former County Manager in Miami-Dade County, agrees and further notes, “On a lifecycle basis, the capital cost of an asset is a relatively small percentage of the total cash flow needed over the life of the asset. To get a true picture of the cost of funds for any project, you have to blend the rates across the capital, operational and financing components of the project. The municipal debt versus private equity cost variance for the construction phase of the project is a very small part of the overall life cycle cost analysis. You can’t get locked onto the notion municipal debt is cheaper therefore the entire project will be cheaper — to me that thinking is akin to the tail wagging the dog.”

Burgess points to the Port Miami Tunnel project. Miami-Dade County was a significant financial participant, as was the P3 concessionaire, and

the contracting agency, which was the Florida Department of Transportation. He continues, “I think the fact the private concessionaire and contractor had skin in the game was extremely important. The P3 team had to deliver a project that met our performance expectations – if it’s not delivered, they don’t get paid. And remember, that private equity is somebody’s money. It’s incumbent upon the P3 concessionaire and their team to deliver a successful project so that they were able to ensure a recurring way to generate expected returns for their investors.”

Per a recent Brookings Institute Report, the authors noted:

“It is important to recognize that the shortfall in the provision of infrastructure is a problem of inadequate funding, not a shortage of financing. The United States benefits from a financial system of extraordinary depth and breadth. New infrastructure projects that embody adequate provision for future cost recovery can be easily financed within the existing system.”

Similarly, North Texas transportation organizations have relied on P3 to deliver several projects in recent years. Cintra, a company that specializes in P3 infrastructure projects, currently manages the \$2.1 billion North Tarrant Express, which opened in 2014, as well as the \$2.6 billion LBJ Express, opened in 2016. Both projects were completed ahead of schedule and are credited with reducing congestion on their respective roadways by more than 60 percent. Cintra is also overseeing construction of the \$1.4 billion North Tarrant Express 35W project north of Fort Worth that is expected to open in 2018.

When asked if he’s found P3s more expensive than traditional delivery, Alberto Gonzalez, CEO of the LBJ Express, North Tarrant Express (NTE) and NTE 35W for Cintra, says, “While I think

we'd have to evaluate on a case-by-case basis, in general, I don't think P3s are that much more expensive than traditional delivery in many cases. Many projects financed by cheap municipal debt and awarded to the lowest bidder lack the built-in P3 incentives to budget for the asset's maintenance over the long run. Maintenance isn't sexy, but it sure is expensive if not done regularly. Also, other benefits of P3s, such as no cost or schedule overruns, the benefit of having projects delivered ahead of time, etc., are usually left out of the equation."

THE O&M ADVANTAGE

Fiction: An asset financed entirely by a public entity will operate the same as an asset delivered through a P3.

Fact: Public assets funded through conventional low bid methods cannot take advantage of innovative ideas or new opportunities...and do not incorporate an operations and maintenance component.

We all know that the actual cost of any infrastructure asset is not a simple calculation. As noted above, the total cost of an asset is the sum total of capital cost, operational cost and financing cost.

Phillips says, "The financing cost is just one component of the overall asset. It's an important component, but there are also other elements such as risk transfer, construction, schedule and cost certainty in addition to social outcomes that are equally important."

Andrea Warfield, Vice President of O&M at Fluor Corporation, agrees. She says, "State and local government agencies are strapped for funding. Most don't have the ability to look out 30 years to plan comprehensive operational and maintenance activities on existing structure. The value of a P3 for certain projects is that they are absolutely guaranteeing the service life of that

infrastructure. In my opinion, they're not only guaranteeing the service life, they're making it better."

Like Phillips and Warfield, Gonzalez points to opportunity benefits. He says, "These are opportunities that might include having the project today versus 10, 15, or 20 years from now when you might have the funds from the public sector to build it. Or the economic boost that these projects provide to communities as we're seeing in our projects here in North Texas. When companies move near these new transportation corridors, employment grows, which generates additional resources for the cities."

Proponents also note that the cost certainty aspect of a P3 is difficult to align with conventional project delivery. Public projects are often fraught with cost and time overruns; those delivered on time and on budget are anomalies, not the norm.

Gonzalez says, "With P3s, we have certainty in cost and delivery. If those schedules and budgets are not met, penalties are assigned." On three P3 projects (LBJ Express, NTE and NTE 35W), Cintra has invested around \$6 billion in the region with less than \$1 billion dollars of public funds.

Gonzalez affirms, "Just looking at the initial investment, the leverage that the State has achieved with P3s is significant. The developer is taking responsibility for the operations and maintenance. On our projects, we estimate that over the next 50 years, we are saving the state another \$5 billion dollars in operations and maintenance."

Bottom line says Moss, "If public entities want to get infrastructure built, they shouldn't simply default to traditional financing methods—there are other options that can get a project built for the same or less money. Make a business case and select the optimal way to deliver and maintain an asset. In our studies, we've found that one in seven projects, about 15% of the time, the smaller ball is P3."