The debate over private infrastructure financing in the United States

Financing costs are higher, but the results are worth it.

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The public-private-partnership or private-finance-initiative model has been used since the early 1990s to finance and procure infrastructure projects around the world. In Australia, Britain, Canada, parts of continental Europe, and, more recently, in the United States, the use of private-sector capital and expertise has helped to fund many high-quality infrastructure assets.

Plenary Group, for example, is successfully delivering a government-accommodations facility in Canada, a highway project in Queensland, Australia, and a comprehensive university-development project in California.

But the private model is not without controversy. Specifically, while projects procured as PPPs have delivered high-quality infrastructure to taxpayers, the higher cost of financing PPPs—the difference between the government's cost of borrowing and the cost of private capital—remains a topic of public debate.

It is fair to ask what taxpayers get for this financing premium. Do the benefits of PPPs outweigh the extra financing costs? Without a proper analysis of this question, getting a PPP program off the ground is likely to be challenging.

In Australia and Canada, such analysis has been carried out. Essentially, agencies in both countries have concluded that, while private finance is more expensive, the government gains private-sector innovation, transfers substantial risk, receives efficient whole-of-life treatment of the asset, and, ultimately, generates more value than if the government financed the project itself. Partnerships British Columbia and Infrastructure Ontario, which are responsible for the vast majority of Canadian PPP projects, as well as Infrastructure Australia, have published comprehensive methodologies that compare the private-financing premium with the value of the benefits that PPPs can provide. All three agencies have found that using PPPs or alternative financing and procurement methods can be cost effective.

While the financing model is sound, the delivery of big and complex public infrastructure projects in the United States under publicly run models is characterized far too often by construction delays, cost overruns, and longer-term performance failures. Even cost overruns of 10 or 20 percent—a level widely accepted as "success"—can compromise a government's ability to deliver its agenda and meet its communities' infrastructure needs. Contrast that with the record in Ontario, North America's most active PPP market. According to an independent report commissioned by Infrastructure Ontario in 2014, the region delivered 36 of 37 recent PPP projects under budget.

There is now general consensus in the United States of the need to improve infrastructure delivery. There is also growing recognition that PPPs maintain public ownership while allowing for the full transfer of infrastructure asset risk away from the taxpayer. Done right, experience has proved that PPPs can provide delivery and operational certainty, protecting the public purse throughout construction and well into operation.

As PPP interest builds in the United States, the questions now focus on how to effectively mitigate project risks compared with other public delivery models and whether the associated private-capital premium is justified.

To understand the answers, it is useful to think of the incremental cost of private finance in a PPP, at least in part, as a guarantee against the risks of poor design, budget and schedule overruns, and deferred or inadequate maintenance, and also as a warranty on overall asset performance. In a traditional procurement, taxpayers pay more if these risks materialize. In a PPP, the private partner assumes these risks in exchange for returns on invested capital.

Also, the private partner has an incentive to not abandon a challenging project because the cost of delivery is financed up front and only repaid if and as the asset performs over time. As a result, and in order to efficiently bid for a project and still protect their long-term investments, private-capital providers take a whole-of-life view and provide an important oversight function not present in a traditional procurement.

Of course, the actual cost of this risk transfer—the premium paid—must be right. In a mature PPP market like Canada, where investors have developed confidence in PPP developers and their teams, the premium ranges from 130 to 220 basis points relative to pure public financing. The figure depends largely on the robustness of the project structure and state of the private-debt markets.

Although the PPP market in the United States is not as developed, the spreads between public and private finance have been comparable. This is particularly impressive given the depth and historically low costs of the US public-finance market. This includes products such as general obligation bonds; private-activity bonds (PABs); certificates of participation; 63-20 financing, for not-for-profit corporations; and credit-assistance programs, such as the Transportation Infrastructure Finance and Innovation Act (TIFIA) and the Water Infrastructure Finance and Innovation Act. What is essential is that the projects have sufficient private equity at stake to ensure successful project management and long-term risk transfer.

While PPPs are still far from the norm in the United States, Plenary is already delivering five projects using different financing structures, including TIFIA, PABs, and taxable bank and bond debt—in each case backed by Plenary's equity investment. These projects are the Long Beach Civic Center; campus development for the University of California, Merced; the US 36 Managed Lanes road in Colorado; the Pennsylvania Rapid Bridge Replacement Project; and the State Street Redevelopment Project in Indiana.

In the end, PPP projects are good value for taxpayers. They pay a relatively small finance premium in return for high-quality infrastructure, and they are delivered faster, at a fixed time and price, and with full asset-life guarantees and warranties from the private sector. Governments in the United States can use the lessons learned from other countries, as well as recent local success stories, to help advance the public discussion and ensure all stakeholders understand the value that private finance can bring to infrastructure delivery.

Ultimately, I am confident that history will judge the use of PPPs in North America favorably, based on the scale, quality, and speed of infrastructure delivered and the lower whole-of-life-costs that can be achieved.