Public Equity to Match Private Investment in Infrastructure

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When it comes to building major infrastructure projects – passenger rail, highways, bridges and ports – we often hear the refrain: *"Let the private sector do it!"* The private financing advocates cite Florida's new Brightline service from downtown Miami to Orlando[1], and Texas Central's planned high-speed rail line from Dallas to Houston,[2] both of which are being developed without public grant funding. At the same time, many on the political left are highly suspect of private control of public infrastructure, fearing that the goal of maximizing profit for private investors will lead to high user costs, shoddy construction, and poor maintenance. Recently, advocates of the Green New Deal have argued that every penny should be provided by government, fearing that "P3s" would reorient the Green New Deal toward financial rather than social goals.[3]

To cut through this debate, I would like to suggest *a middle road* for reinvestment in big infrastructure projects that parties on both sides of the political spectrum should be able support. My proposal is this: **a federal grant program to match private investment**. Proposals from project developers would be evaluated based on the percentage of the capital cost that could be financed with private investment. Minimum construction and operating standards would be set by the public sponsors.

Often the argument about infrastructure investment revolves around how much of the cost of such projects should be borne by the federal government. Two years ago, the White House released a $1.5 trillion infrastructure proposal. However, under their plan state and local governments, along with private investment entities, were expected to provide 80 percent of project funding, while the federal government would kick in only 20 percent.[4] Today most recognize that in a post-COVID fiscal environment, local governments would be hard pressed to provide the lion's share of such funding.[5] The recent House-passed Transportation Reauthorization bill reverses the split, providing for a federal share of up to 90 percent.[6]

Could Private-Sector Funding Bridge the Gap?

Certainly private sector financing backed by project revenues has been shown to be a key strategy for many projects. But what those who would substitute 100% private investment for government funding fail to understand is that the oft-cited Florida and Texas projects are exceptional. The Texas Central project benefits from very high projected ridership by connecting two of the fastest growing cities in the United States in less than 90 minutes. At the same time the cost of right-of-way construction will be lower than average because of the flat terrain it crosses between the two cities. Japanese investors reportedly examined dozens of other city pairs before deciding that Dallas to Houston was by far the most economically feasible.

In Florida, the Brightline service employs less expensive diesel technology over an existing freight corridor owned by the project's original sponsor, Florida East Coast Railroad. These factors allowed them to avoid the high cost of electrification as well as construction of numerous expensive grade separations.

Certainly, many Republicans would prefer to look to the private sector to carry out infrastructure development instead of direct government expenditures. And there is no question that there are billions of dollars of cash in public pension funds and private investment vehicles that are eager to invest in US infrastructure projects. Most Democrats don't disagree--provided that P3s balance public and private interests.

The limitation of private investment is that equity and debt financings require a reliable source of repayment, typically user fees in the case of infrastructure highway and rail infrastructure, sometimes supplemented by related real estate development.

The harsh reality is that, with a few exceptions like the Texas and Florida projects noted above, the largest, most critical projects costing in the billions of dollars, cannot rely on project revenues alone to support the entire capital cost. There is always a point at which tolls, fares or other user fees cannot be increased without reducing overall returns.

The obvious solution for most revenue-generating infrastructure projects to is combine both public and private investment. Project sponsors could seek out competitive proposals from private companies to build and/or operate capital-intensive projects, evaluating them based in part on the size of private equity and debt contributions that are not repaid from government sources. Government grants (federal, state and local) or "availability payments" from government sources would make up the difference, thus creating a true "public-private partnership."

This approach would make feasible P3 development of projects such as:

- The new Gateway rail tunnels under the Hudson River to replace the 100-year old North River Tunnels that will need to be taken out of service for major repairs within the next 10 years due to damage from hurricane Sandy.

- Making a reality of 220 mph service on the Northeast Corridor providing 90 minute trips from New York City to Boston and Washington DC.

- Completion of the California High-Speed Rail Project from the Central Valley to Los Angeles and San Francisco.[78]

- Construction of the long-sought high speed train from Seattle to Vancouver, British Columbia and Portland.

- Extending XpressWest's proposed line from Las Vegas through to Los Angeles.

- Advancing express rail connectors from city centers to international airports that can no longer be afforded by the now financially constrained urban transit systems, and connecting hub airports to other major cities in the region that are unprofitable for the airlines to serve.

All these projects have attracted significant interest from private companies, but it is unlikely that the billions required to complete them can be financed solely by the private sector.

For multi-billion dollar infrastructure projects of national significance, substantial pubic contributions are needed to bring private financing to the table. ***Neither the public nor the private sector can do it alone.*** But harnessed together they can bring America's highways, ports, rail, transit and other infrastructure back into the 21st Century.

Endnotes

1. https://www.gobrightline.com/miami

2. https://www.dallasnews.com/opinion/editorials/2020/05/17/texas-bullet-train-inches-another-step-closer-to-reality/

3. https://www.businessinsider.com/green-new-deal-climate-change-government-spending-no-private-money-2019-9

4. https://www.whitehouse.gov/wp-content/uploads/2018/02/FY19-Budget-Fact-Sheet_Infrastructure-Initiative.pdf

5. https://time.com/5826016/states-budget-crisis-coronavirus/

6. HR 2.

7. The California High-Speed Rail Project now under construction has been frequently criticized for not seeking private investment, relying instead on a combination of state bond proceeds and federal grants to fund the initial segment through the Central Valley of California. The California High-Speed Rail Authority's 2020 Business plan states that private investment will likely only come after the first commercially viable operable segment—the Silicon Valley to Central Valley Line—demonstrates system viability and maturity. See California High-Speed Rail 2020 Business Plan at p. 122. https://www.hsr.ca.gov/docs/about/business_plans/2020_Business_Plan.pdf

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For more details about the study, download the full report at transweb.sjsu.edu/research/2049

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