

# PUBLIC PRIVATE PARTNERSHIPS: CONFRONTING INFRASTRUCTURE PRIVATIZATION

America's infrastructure needs an overhaul. In 2017, the American Society of Civil Engineers' (ASCE) report card on the nation's infrastructure gave the U.S. a grade of "D+." The embarrassing grade was based on unmet needs to repair and rebuild roads, bridges, drinking water and wastewater systems, schools, rail and transit systems, and public parks. ASCE also estimated that the country needed to increase infrastructure investment by \$2 trillion over the next ten years to recover from decades of neglect and disinvestment.<sup>1</sup>

Some local and state governments are looking at contractual arrangements, called public-private partnerships (also known as "P3s") that use private capital to finance public projects, to help fill the gap. Public funding of infrastructure is well known to be the least expensive way to finance major infrastructure projects.<sup>2</sup> But in light of financial and political obstacles that governments face, some policymakers pursue private financing to build new infrastructure or to privatize existing assets in pursuit of quick cash. Despite the appearance of private investment in communities however, there are significant risks with these deals that can have lasting consequences for the community for decades.

*It is important to note that with all infrastructure projects, regardless of how they are financed and procured, there are opportunities to ensure meaningful economic and social impact for your community by incorporating job quality and equity policies. For more information on these types of measures, see In the Public Interest's publication, Building America While Building Our Middle Class: [http://www.inthepublicinterest.org/wp-content/uploads/ITPI\\_PWF\\_P3BestPractices\\_March2016.pdf](http://www.inthepublicinterest.org/wp-content/uploads/ITPI_PWF_P3BestPractices_March2016.pdf)*

## **WHAT ARE P3S?**

### ***How infrastructure is traditionally built***

New infrastructure projects typically have five important steps, as shown in the graphic below. These include designing the project, and then building, financing, operating, and maintaining the asset.

Traditionally, engineers and architects design the project (can be public or private), construction companies (always private) build it, public agencies operate it and maintain it, and public finance offices manage the money by paying off the debt. Traditional infrastructure projects are built with public debt raised through tax-exempt bonds sold to individual and institutional investors like pension funds and mutual funds. The debt is paid back by individuals and businesses through either taxes or user fees, such as fares or tolls. Traditional procurement methods for infrastructure are typically referred to as design-bid-build (DBB), where the governmental entity does everything except for the construction work; or design-build (DB), where a private entity designs and builds the asset, but the governmental entity finances it, operates it, and provides maintenance services.

## GRAPHIC 1: FIVE KEY STEPS OF A NEW INFRASTRUCTURE PROJECT



### *How infrastructure is built under a P3 model*

The term “public-private partnership” has become an imprecise catch-all that can capture the traditional procurement described above, but is now typically used to describe a project that privatizes all five activities in the process. This is also referred to as a design-build-finance-operate-maintain (DBFOM). In a P3 used for building a new piece of infrastructure, at least part of the financing is provided by the private entity. This is known as “private equity financing.” Private equity financing is considerably more expensive than tax-exempt municipal bonds. On average, the cost of borrowing (interest rate) for municipal bonds is 3%, while the cost of borrowing for private equity is between 10% and 15%, which can dramatically drive up costs related to financing the project.<sup>3</sup>

Of course, all project financing must be paid back. In a project that uses public financing, municipal bonds can be paid back through governmental tax revenues, such as sales or gas taxes, or revenues from the project, such as tolls or water bills. In a P3 model, private equity financing is paid back either by allowing the private entity to collect the revenue stream (i.e., tolls, fares, or other user fees) or through a regular government payment to the private entity called an “availability payment.”

Additionally, existing assets can also be privatized, as in a long-term lease agreement. This is an agreement in which a private entity (or entities) receives the right to collect revenues associated with an existing asset in exchange for an upfront fee to the governmental entity. Examples of this model include the 2008 privatization of Chicago’s parking meters, where the City of Chicago signed a 75-year contract with a global consortium led by Morgan Stanley to run the city’s 36,000 parking meters. This type of arrangement is also commonly referred to as a P3. P3s of new infrastructure and existing infrastructure both carry similar serious risks, described below.

### **RISKS OF P3S**

**Loss of democratic control over public policy and decisions:** Many P3 contracts include non-compete clauses and/or compensation clauses, which limit or eliminate the public’s long-term ability to make critical decisions necessary to improve our cities and transportation systems and to address climate change. For example, Chicago’s parking meter contract mentioned above includes compensation clauses that require the city to pay the corporate consortium for lost revenue resulting from standard policy and planning decisions, such as the creation of new bike lanes or bus rapid transit lanes or temporary uses such as street fairs, for the life of the 75-year contract. These types of clauses have proved expensive for taxpayers—in 2016, the payments to the private entity totaled \$15.7 million, and in 2017, they increased to \$21.7 million.<sup>4</sup>

**Loss of Public Revenue:** Cities that privatize existing public assets give up decades of revenue from those assets, which could be used for important public goods, such as public transit projects or healthcare services, instead of private profits. For example, a 2018 audit showed that Chicago’s parking meter system raked in \$134.2

million in 2017, putting private investors on pace to recoup their entire \$1.16 billion investment by 2021 with 62 years of further cash flow to enjoy.<sup>5</sup>

**Profit motives drive public decisions about what gets built:** Private investors demand rates of returns that need a profitable revenue streams, such as projects that generate high tolls, water rates, or transit fares. If a project does not have a revenue stream, P3s can be structured to require the government to pay guaranteed annual payments, referred to as “availability payments,” which include the investors’ profit margin. Simply put, the private sector cannot be relied upon to provide investment for the many critical infrastructure needs that are not profitable, such as smaller projects, repair projects, or projects in rural areas and communities of color.

**Reduced labor standards:** Promised cost savings often derive, at least in part, from reduced wages and benefits for construction workers who build infrastructure and workers who operate and maintain public assets. In a P3, permanent operations and maintenance workers are private sector workers with lower wages and reduced health and pension benefits than public employees who are often union members with higher quality jobs with benefits. For example, when the Chicago Skyway was privatized using a P3 model, cost savings were largely derived from reduced labor costs. Previously, city workers who maintained the road were paid at least \$20 per hour. The private firm that replaced the city workers paid its workers between \$12 and \$15 per hour.<sup>6</sup>

**Limited access and affordability from increased shift to fee-based infrastructure:** Private investment often brings a heavier reliance on tolls and user fees to pay for infrastructure, as well as the private entity’s return on their investment. This makes progressive affordability schemes, such as sliding scale systems that factor in residents’ financial hardship, or policies that forgive missed payments under certain circumstances, more difficult to create. In practice, privatized projects have resulted in much higher costs for residents, becoming increasingly unaffordable for lower-income people and communities of color, and thus reducing equitable access to critical infrastructure.<sup>7</sup>

**Public information becomes confidential and proprietary:** Publicly financed and operated infrastructure projects are transparent and subject to applicable sunshine laws. Financial documents, planning documents, usage projections, wages, construction contracts, and performance reports are public documents. The rules are different for privatized projects where much of this information is deemed private.<sup>8</sup>

**Potential for reduced community input:** A traditional procurement usually involves multiple phases, including design and construction. A typical P3 bundles phases together into one procurement, which, depending on local and state procurement policy, may limit opportunities for input by the communities most impacted by the new infrastructure.

### ***EARLY WARNING SIGNS OF P3S***

There are a number of early warning signs that could point to the possibility of privatization schemes being considered:

- There are problems with existing infrastructure that have garnered a lot of attention, such as consent decrees, quality issues, billing concerns, and more. This makes the asset vulnerable to calls for privatization.
- There is a large project that needs to be built, but your governmental entity is unable or unwilling to take on additional debt to finance construction costs through tax-exempt municipal bonds. This can be due to a variety of reasons such as general anti-tax sentiment, inability to garner enough support for bond measure, or debt cap concerns.
- The locality or state is experiencing budget deficits. Anti-tax sentiment may make privatization schemes seem like a reasonable solution to fiscal deficits, despite the enormous risks and greater long-term expense.

- Private corporations that seek privatization deals may cultivate privatization champions in your governmental entity. For example, corporations and/or their lobbyists may target and develop relationships with mayors and other political leaders to help them become advocates of infrastructure privatization schemes.
- If other localities in the area have engaged in privatization schemes, corporations may target your locality in an effort to cluster contracts near each other and achieve greater economies of scale. For example, water privatization companies may target the privatization of smaller water systems in areas where they already have contracts.

There are many levers and decision making points that local and state policymakers can use to effectively intervene in a proposed infrastructure project. Depending on the proposal, there are a number of outcomes policymakers may want to work towards. You may want to: 1) turn a bad project into a good one by changing the structure of the procurement to minimize the level of privatization and preserve as much public control as possible 2) improve deals to ensure that the community benefits from the project. 3) completely stop the project if it would be harmful to the community or put inappropriate financial burdens on residents. Below are some steps and ideas on how to intervene in a proposed project.

### **WHAT DO TO - KNOW THE BASICS**

The first step that provides the foundation for intervening in projects is understanding the basic landscape of the project proposal and process. This information is necessary in understanding potential levers and points of intervention.

- Identify existing infrastructure needs and plans in your region. Get familiar with your city or state's infrastructure plans, such as any Capital Improvement Plans (CIPs), strategic plans, or master planning documents. There may be different plans for different types of infrastructure, such as transportation, water systems, and public transit. You should understand what's in them and why. Understand whether and how a proposed project fits into these plans. More information about where to find and how to understand your locality and state's infrastructure plans is included in Appendix A at the end of this brief.
- Know what local and state laws are applicable to a proposed infrastructure project. For example, some states have their own environmental standards that apply to infrastructure projects. Some localities have specific worker standards (wage standards, healthcare requirements, etc.) that projects may be subject to.
- In many cases, a state or locality will have P3-enabling legislation that lays out the ground rules for P3 deals, such as how the procurement process must flow, any requirements for the resulting contract, and more. It's important to understand if the state has P3-enabling law and what requirements it sets forth, and also what deficiencies are in the law so you understand where there may be potential problems you'll need to address. For more information about best practices in P3-enabling legislation, see In the Public Interest's report, *Infrastructure Justice*: <http://www.inthepublicinterest.org/wp-content/uploads/P3-Legislation-Recs-final.pdf>
- It is important to understand your locality or state's financial position and existing obligations that may impact the way it approaches the proposed project. What is the governmental entity's bond rating? What are its existing debt obligations? Are any of these predatory financial structures involving variable-rate bonds, auction rate securities, or toxic interest rate swaps? Does some feature of its existing financial position impact its decision to explore the use of a P3 for the proposed project?

## **WHAT TO DO—ASK THE RIGHT QUESTIONS**

Once a proposal is in motion, one important strategy is to “ask the right questions.” What this means is asking hard questions that force other policymakers, agency officials, and privatization proponents to critically think about the details and issues and get answers to questions about the project that you think are important. It allows you to frame the debate and inject your values and framework into the conversation. It also can have the strategic impact of delaying decision making, which can be important in circumstances when you may need more time to analyze the proposal, and invite more public input and participation. For a good list of hard questions for proposed P3s that can be adapted to your specific project of interest, see In the Public Interest’s *Guide to Understanding and Evaluating Infrastructure Public-Private Partnerships*: [http://www.inthepublicinterest.org/wp-content/uploads/ITPI\\_InfrastructureP3sGuide\\_Jan2017.pdf](http://www.inthepublicinterest.org/wp-content/uploads/ITPI_InfrastructureP3sGuide_Jan2017.pdf). A few questions have been excerpted below:

### ***What options has your city, county, or state examined?***

- What are the various procurement methods being considered for the project and what is the rationale for each option?
- Has the governmental entity performed or contracted for an analysis of various procurement options? In most cases, governmental entities rely on a Value for Money (VfM) analysis to compare lifecycle costs of designing, building, financing, operating, and maintaining an asset when using various procurement methods. A VfM analysis typically compares traditional procurement such as design bid build (DBB) or design build (DB) to a P3 procurement approach such as a design, build, finance, operate, and maintain (DBFOM).
- How does the VfM analysis justify one procurement option over others? Methodology can dramatically alter the results of the VfM analysis. It may be necessary to get outside expertise, such as from a consultant that has a record of not pushing P3s, or have internal expert staff review the VfM analysis, including the assumptions used, identified risk factors, and calculation details. Note that this is a very important step in the process, and in most cases the analysis is used as a justification for using a P3 model. Once P3 proponents have a quantitative study that shows P3s are a better choice, even if it is a flawed analysis, it is treated as fact and difficult to later reverse. As soon as the VfM analysis is complete, lawmakers need to ensure they receive a copy and carefully examine the analysis and bring attention to places where it falls short or doesn’t adequately justify the chosen approach.
- Does the VfM analysis and broader analysis of options consider non-financial public interest criteria including social, racial, and economic impacts; affordability and accessibility of the infrastructure to low income communities; the number of high quality jobs the project will create; environmental impacts; and accountability and transparency measures?
- If the government must use private equity financing, has it considered the option of using direct public employees for some or all of the maintenance and operation of the asset, instead of outsourcing these functions?
- If an existing asset is being proposed for privatization, has the governmental entity performed or contracted for a valuation of the asset? If so, how was the valuation determined and what methodology was used? The methodology can dramatically increase or decrease the valuation range. It may be necessary to get outside expertise to review the valuation and methodology, including the assumptions used and the details of the calculations.
- If an existing asset is being proposed for privatization, has the government prepared an economic analysis describing potential revenues and expenses if the asset remained in public hands? Has the governmental

entity identified alternatives to privatization that include rate or fee increases going directly to the public entity rather than a private contractor? Alternative options could also include the governmental entity improving its management of the asset, probably with increased fees or rates.

### ***How will your city, county, or state finance the project?***

- Why is private equity financing being considered for the project in lieu of traditional public financing? Has traditional public financing been considered?
- Are there obstacles in the way of public financing?
- What other funding and financing streams will be used for the proposed project?

### ***What is the long-term impact on your government's budget?***

- How will the governmental entity compensate the private entity? Typically, private investors are paid back through the rights to revenue streams associated with the asset (such as tolls or fares) or through regular payments from the governmental entity, known as availability payments. For more information about availability payment schemes, please see In the Public Interest's publication, *Availability Payments in Public-Private Partnerships: Issues and Implications*: [http://www.inthepublicinterest.org/wp-content/uploads/ITPI\\_AvailabilityPayments\\_May2018FINAL.pdf](http://www.inthepublicinterest.org/wp-content/uploads/ITPI_AvailabilityPayments_May2018FINAL.pdf)
- What are the implications of the compensation scheme to your government's budget?
- What are the transaction costs that the governmental entity will incur with a P3 approach, such as contracting costs and oversight costs?
- Will the governmental entity incur hidden costs with a P3 approach? For example, jobs created from a project that pay low wages or fail to provide health insurance benefits may result in an increase to another part of a governmental entity's budget, as the need for social safety net services will increase.
- An existing asset might provide revenue to the governmental entity. If the asset currently provides net revenue to the budget, how is that revenue spent and who benefits from that revenue? Will the loss of that revenue disproportionately impact low-income communities or communities of color? Importantly, how will that revenue be replaced?
- If a proposed privatization deal for an existing asset requires investors to make a large upfront payment to the governmental entity, are there budget restrictions that prevent the funds from being used too quickly?
- How will the proposed privatization deal impact the governmental entity's bond rating? Are there risk factors associated with the deal that could impact the governmental entity's future cost of borrowing?



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Local Progress is the national network of progressive elected officials from cities, counties, towns, school districts, villages and other local governments across the country. Our members are committed to reclaiming the power that cities and counties have and to advancing our shared vision of shared economic prosperity, equal justice under law, livable and sustainable communities, and good government that serves the public interest.

# APPENDIX A: UNDERSTANDING YOUR REGION'S INFRASTRUCTURE PLANS

For any stakeholder interested in ensuring that infrastructure is progressive and creates broad benefits for your community, one of the most important first steps that you can take is identifying infrastructure needs and plans in your area. While infrastructure planning will look different in each locality and region, the following guide is designed as a basic starting point to help you gather the right information and ask the right questions to better understand your area's infrastructure priorities.

- 1. Understand what governmental entities are responsible for particular infrastructure needs.** For example, what is the city responsible for? Is there a separate water authority that oversees the water and wastewater system? Is there a separate transit authority that oversees public transportation infrastructure? It can be helpful to think broadly about the type of infrastructure that you are interested in and make sure that you know which governmental entity is in charge of each infrastructure type. Infrastructure can include things like roads, bridges, parks, government buildings, jails and other correctional facilities, transit systems, parking facilities, water and wastewater systems, schools, and more. Hint: Locate and identify big projects, there will be lots of small things, so don't get lost.
- 2. Locate your city's or state's most recent Capital Improvement Plan (CIP).** Cities will typically use a Capital Improvement Plan to identify priority capital projects in the 5 year range (although some may cover shorter or longer timeframes). It may include a planning schedule and options for financing the projects. These are typically updated every year or every couple years to reflect changing priorities, so it's important to obtain the most recent version. Understand what departments/agencies are covered in the CIP, since other types of infrastructure may fall under other agencies'/authorities' jurisdiction, as discussed above. You will have to contact that specific agency/authority/etc. to obtain its CIP. For example, some regional water authorities, transit authorities, or airport authorities may have their own CIP documents.
- 3. Locate your city's or state's long-term infrastructure plan.** Many cities and other governmental entities create long-term planning documents to put forth a vision of the future of the city or region. Sometimes these long-term plans project 20-30 years in the future. While not as helpful as CIPs in identifying specific projects, locating and analyzing these long-range plans can be helpful in understanding how policymakers and planners see the area developing over the next few decades and what bigger-picture values and rationales are driving infrastructure decision-making. Note that long-term plans may cover all a city's infrastructure plans, or there may be separate long-term plans for different types of infrastructure, such as water, transportation, public transit, etc.
- 4. Check if your city or state has infrastructure maps.** Some cities and other governmental entities utilize mapping technologies to show where active projects are located and where prospective projects would be located within the region. This can be a convenient tool in understanding how projects may impact particular neighborhoods and communities. These maps can typically be found on the city or governmental entity's website and are sometimes even interactive.

5. **Understand how available bond proceeds are being spent.** Cities may issue bond program reports at particular points in time to update the public on how bond proceeds have been spent and how they will continue to be spent in the future. These reports may contain important information about upcoming projects that are already funded, and can be an important source of information for advocates wanting to ensure already funded and scheduled projects meets the needs of the community. One question to understand is what major bonds have passed for infrastructure that are still being used to fund current or future infrastructure.
6. **Identify any committees with authority over infrastructure planning.** There may be a planning committee or other type of body that regularly meets to assess infrastructure needs and plans. Sometimes these committees are involved in the Capital Improvement Plan mentioned above. Accessing minutes of these meetings and other documents that come from the committee can also shed light into how planning priorities are made and rationales behind planning decisions.
7. **Identify any infrastructure projects that were authorized by specific legislation.** Some infrastructure projects may be authorized through city ordinance or legislation. Keeping an eye on introduced legislation related to infrastructure, especially infrastructure that may be financed outside of traditional public finance methods, can help you identify a specific project in its early stages.



# NOTES

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3. Kevin DeGood, “Trump’s infrastructure plan leaves U.S. behind, enriches Wall Street,” Market Watch, December 12, 2016. <https://www.marketwatch.com/story/trumps-infrastructure-plan-leaves-us-behind-enriches-wall-street-2016-12-10>
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6. Eduardo Engel, Ronald Fischer, and Alexander Galetovic, “Public-Private Partnerships to Revamp US Infrastructure, The Hamilton Project, February 2011. [http://www.hamiltonproject.org/assets/legacy/files/downloads\\_and\\_links/Final\\_ENGELD-iscussPap\\_Feb2011.pdf](http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/Final_ENGELD-iscussPap_Feb2011.pdf)
7. See examples from In the Public Interest, “How Privatization Increases Inequality” Section 2, September 2016.
8. For an example of this dynamic, see Katherine Blunt, “The End of the Road,” San Antonio Express-News, September 16, 2016. <http://projects.expressnews.com/the-end-of-the-road-texas-130-toll-road>