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Build Back Better - How PPP can support Biden's BBB plan

An Operis white paper by Carmen Wade, Financial Advisory, Head of North America and Erwan Fournis, Global Head of Financial Advisory

Introduction

The US Senate recently voted to move forward on President Biden's Bipartisan Infrastructure Framework (the Framework). The Framework, called "a generational investment to modernize our infrastructure" includes approximately $550 billion in new infrastructure spending, an amount roughly equivalent to the cost of the US Interstate Highway System, after adjusting for inflation, according to The New York Times. While far short of the original $2 trillion plan, the Framework still represents a massive investment in infrastructure over the next eight years. Some 50% plus of the investment will go to transportation & transit infrastructure, with the remaining approximately 50% committed to water, power, broadband, environmental remediation and resilience.

The Framework is intended to be financed through a number of bipartisan initiatives including unused Covid-19 aid and unemployment benefits money, delaying a drug rebate rule and funds from economic growth.

Benefits of PPP beyond funding

Regardless of how the infrastructure is funded or financed, Public Private Partnerships (PPPs) should be considered as a potential delivery model. PPPs should not be considered solely as a funding source. Doing so undermines the extent of the value the procurement approach offers. Thinking of PPPs as simply a source of funding means many authorities, who don't necessarily need funding, disregard the model and utilize sub-optimal delivery models and approaches for their infrastructure assets. PPPs in the US are also commonly associated with toll roads, given the history of their use in the country, but the application of the PPP model can be broad and varied, including both vertical and horizontal infrastructure, and either revenue risk transfer or availability payment models (i.e. where the public sector authority keeps the demand risk (e.g toll revenue) and pays the private sector a monthly fee for keeping the asset available for use). The UK, Australia, Canada and other global jurisdictions have effectively used PPP models to deliver substantial infrastructure programs. These jurisdictions have leveraged private sector investment in infrastructure to deliver infrastructure plans far greater than single year government budgets but have done so primarily in order to capitalize on the relative strengths of each of the public and private sectors and to take advantage of the benefits the PPP model offers:

1. Pay for Performance

The use of private financing to help ensure performance tends to result in assets delivered on time and on budget, and assets that are efficiently operated and maintained over the life of the contract.

2. Whole-life costing and budgeting

Most countries, but the US in this instance, are challenged with infrastructure maintenance and renewal, and now have an estimated US$1 trillion deferred maintenance expense (according to a 2019 Volcker Alliance report), assets with significantly reduced lifespans and in decrepit condition (e.g. about 25% of bridges in the US are either structurally deficient or functionally obsolete)[1]. PPP delivery models such as a Design-Build-Finance-Operate-Maintain compel public authorities and contractors alike to (a) consider operational, maintenance and lifecycle requirements right from the design phase of the asset and (b) budget and contract for the upkeep of the asset over the term of the contract (usually 30+ years).

3. PPP projects are typically procured through performance-based specifications versus prescriptive input-based specifications

The discipline of thinking through what is important from an asset performance (or user experience) perspective versus the list of ingredients that goes into the asset (or bills of quantities), typically results in a better overall solution by allowing for the introduction of private sector innovation and technology. The output-based perspective can, and increasingly does, include Environmental, Social and Governance (ESG) in addition to defining the performance of the asset.

Creating a thriving PPP Sector

Irrespective of the funding or financing source for a particular project, PPP should be considered as a procurement option for the asset. To build up a strong and effective PPP sector, however, the US will need to address a number of challenges that currently hinder a thriving sector to develop:

1. Definition

First and most basically is a definition of a PPP. Definitions and understanding across the US vary. In many instances any collaboration between the public and private sector is called a public private partnership. In the context of infrastructure, a Public Private Partnership is a long-term contract that includes elements of risk transfer and pay-for-performance typically financed by non recourse private sector project financing. Clarity on the definition and benefits of the model is critical when seeking political, general public or other stakeholder support.

2. Enabling environment

Second, it is critical to have an enabling environment that includes:

- appropriate policy, legal and institutional frameworks;
- strong and stable cross-political support for PPP programs, given the long lead time and typical concession tenors;
- a consolidated PPP pipeline making it easy for the private sector to find projects of interest and know when they will be coming to market, thereby enabling a scale up of resources committed to the PPP sector;
- Implementation teams with knowledge and capacity, to match the scale and complexity of the infrastructure program; and

[1] *Hajializadeh, D.; Obrien, E.; O'Connor, A. Virtual structural health monitoring and remaining life prediction of steel bridges. Can. J. Civ. Eng. 2017, 44, 264–273.*

- Standardized approaches to PPP procurement and contract templates in order to reduce procurement timelines and costs. Standard form contracts can, nevertheless, be tailored in specific areas in order to respect the uniqueness of each project and optimise the tax payer's value-for-money outcome. Revenue risk is a good example of a risk that can be effectively transferred in certain projects, but would result in an uneconomic financial position in other projects.Critically, many US States still do not have PPP legislation. There currently does not exist a consolidated pipeline for the US; even in the majority of States, there is no consolidated pipeline of major capital projects being procured or executed as PPP. There is large variability in the skills and knowledge of the authorities trying to execute PPP programs, as well as the approaches used by those authorities. Additionally, the political system creates immense challenges trying to undertake projects that require more than a four-year runway.

3. Certainty

The private sector likes certainty, in particular certainty that once launched, procurement processes will get to financial close. This can be illustrated by the success of UK, Netherlands and Canada whose announced pipelines provided both medium term visibility and have almost always carried through to financial close and beyond.

The amount of money at play in the US is large enough to keep investors/developers interested despite the number of aborted PPP projects. There may also be a degree of "fear of missing out" helping maintain some strategic patience from developers. Should interest decline, the top tier infrastructure developers could take their expertise and dollars to the many countries that are also launching massive Covid recovery infrastructure plans and will compete for investment with US projects. In reality, however, the US opportunity is "too big to miss" so developers will continue to be patient. Nevertheless, a stop and go approach wastes time and energy, making certainty as big a benefit to the public sector as it is to the private sector.

In the US context, these success factors should be considered at the State rather than federal level, but in the same way that the European Union fostered PPPs through union-level initiatives such as EIB financing or the European PPP Expertise Center, the Federal Government could also support, with expertise and funding/financing, individual states' PPP initiatives.

Lessons from international jurisdictions

PPPs are not a panacea and are not, in fact, all structured similarly. Looking at the broad asset classes considered for investment under the Biden Framework, the US could look abroad at lessons learned from other jurisdictions that have procured similar assets. For example:

- rural broadband cannot efficiently or effectively be left to the private sector to finance on its own; some form of public support is needed to achieve the objective of broadband access for all. France used its concessionary framework to increase predictability of revenue (by providing a monopolistic position to the concessionaire) whilst the UK has chosen a subsidy framework that fosters land grab strategies by operators;
- social infrastructure can be efficiently procured through PPP contracts, being inherently tax-funded assets. The plethora of hospitals, water treatment facilities, sports/recreation facilities and justice facilities procured in Ontario, Canada are prime examples;
- heavy rail (in particular High-Speed Rail) is best funded publicly given the track record of time and cost overruns, which makes a traditional PPP risk transfer uneconomic. In the UK, HS1 (the Channel Tunnel rail link) has proven that the government can successfully monetise future patronage income after the asset has been built. (For those not familiar with HS1 – the asset was originally procured using a PPP, however due to significant cost overruns, the Government ended up taking back the project and completing construction. Post construction, a second PPP for the operations, maintenance and lifecycle upkeep of the asset was successfully established. A similar approach, i.e. a post construction PPP was followed for Highway 407 in Ontario, Canada.); and
- traditionally tolled roads and bridges can be procured using an availability model, as evidenced by the Gordie Howe International Bridge and Highway 407E Extension. The advantage of using an availability model even in a tolled environment is that the authority owns the "upside" should traffic materialize above expected levels, and the cost of financing without transferring demand risk is significantly lower.

Summary

Despite the remaining political hurdles it faces, the Biden Infrastructure Framework is exciting in the commitments made to improving and growing America's infrastructure. Regardless of how the infrastructure is financed, PPPs should be considered as a potential delivery model and lessons learned from international jurisdictions used to inform planning. The Government's investment in infrastructure can be further leveraged to attract private sector investment through the use of PPPs, but the process of defining the intended outcomes, introducing private sector innovation, experience and expertise, and planning and budgeting for the long-term upkeep of the asset is of equal importance. In most States, and certainly at the country level, to achieve this will require investment in the enabling environment. Attracting additional investment for infrastructure and using PPPs to ensure the upkeep of assets for decades to come makes smart sense and will almost certainly contribute to the US's ability to "Build Back Better."

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Carmen is the North American lead for Operis.

She has extensive experience managing complex projects and providing insightful financial, commercial and procurement advice. Carmen was a partner at Deloitte where she advised on many projects, including the high-profile cross-border Gordie Howe International Bridge project. Carmen partners with her public and private sector clients to deliver strategic infrastructure and energy projects.

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Erwan has extensive experience in infrastructure and energy projects. He takes a close interest in his valued clients' projects, having himself held positions as an equity investor earlier in his career.

Erwan joined Operis in 2020. In his career in infrastructure & energy project finance, including over 13 years with various infrastructure funds, he led many high profile transactions and gained a thorough understanding of projects in Europe, North America and Australia, throughout their lifecycle.

Operis is a leading advisor in project finance, renowned for its expertise in financial modelling. Since its start in 1990, Operis has built on this distinctive strength and supported more than 1,200 projects worldwide.

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