

## **Policy Brief:**

*Innovation in the P3 Marketplace*



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## Policy Brief: Innovation in the P3 Marketplace

### Introduction

Public Private Partnerships (P3s) – business arrangements that allow government and private entities to share resources (both skills and assets) and spread risks in order to deliver a service or facility to the general public<sup>1</sup> – are traditionally thought of as a financing tool for transportation infrastructure. However, in recent years investors and public entities in the U.S. began viewing P3s through a more innovative lens by introducing the P3 model to less traditional, non-transportation infrastructure projects, and finding new ways to package and finance all P3 projects, including transportation infrastructure.

The U.S. has been a slow adopter of P3s compared to our international counterparts, but this is beginning to change. According to Moody's Investor Service as recently as March 2016, the U.S. market is "positioned to become one of the world's largest."<sup>2</sup>

### Expanding Beyond Transportation

States and local government entities across the country are experiencing severe budget crunches, but that doesn't diminish their desire to upgrade, improve and diversify their

infrastructure networks. At the same time, many communities expect services that have long been considered luxuries, like broadband connectivity to be universally available similar to any other utility. As a result, many are looking to P3s to close the gap between what they aspire to build and what they can afford to build.

For example, Kentucky's statewide broadband initiative, KentuckyWired, a first of its kind P3 closed in September 2015. KentuckyWired will make broadband accessible throughout the entire state of Kentucky, including rural areas, for the first time. While the state-owned, but privately funded and operated, broadband network will not deliver Internet service directly to users, it will provide what is called a "middle mile" network allowing internet service providers (ISPs) to bring services from the state owned network into homes in businesses without investing billions of dollars expanding their networks into sparsely populated areas.<sup>3</sup>

Pennsylvania is using a P3 agreement to install 29 new Compressed Natural Gas fueling stations throughout the state from

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<sup>1</sup> The National Council for Public---Private Partnerships, "7 Keys to Success," accessed May 2, 2016.

<sup>2</sup> Moody's Investor Service, "Moody's: U.S. Public Private Partnership Market Steadily Growing," March 10, 2016.

<sup>3</sup> KentuckyWired, "Frequently Asked Questions," accessed on May 3, 2016.

2016-2021.<sup>4</sup> While all of the stations will be located at public transit agency sites, 7 of them will be available to the general public.<sup>5</sup>

The state is looking to capitalize on its abundant natural gas resources, and estimates the project will save public transit agencies more than \$10 million in fuel costs annually.<sup>6</sup> Pennsylvania estimates the P3 structure will save the state more than \$46 million in capital costs.<sup>7</sup> However, the project does a lot more than save money – it will make low cost CNG available to Pennsylvania drivers, small businesses and fleet owners. It will also reduce carbon dioxide emissions by 20 million pounds annually.<sup>8</sup>

Many states are even using P3s to improve the campuses of state universities. The University of California Merced is using a P3 on its 2020 Project, which is aimed at increasing long-term enrollment growth to 10,000 students by adding nearly 900 million square feet of classrooms, laboratories, student residences and more – doubling the campuses physical capacity.<sup>9</sup> Purdue University in Indiana is using a P3 for its State Street Redevelopment project. This

project, expected to be complete in 2018, will take advantage of State Street's re-designation as a locally controlled route by making it less a thoroughfare and focus more on resident business and student needs.<sup>10</sup>

The diversity of P3 project types across the country is an encouraging sign. As P3s become more common across the country, traditional infrastructure impediments like federal, state, and local budget constraints could become a thing of the past for projects viewed as worthy of private sector investment.

## Innovative Financing

States and localities are also getting more creative in how they structure the financing and package both transportation and non-transportation P3 projects. Recent projects have broken numerous barriers ranging from using tax-exempt bonds in new ways to bundling multiple projects into a single P3. In addition to its unique broadband offering, the aforementioned \$232 million KentuckyWired project used “creative and complex structuring,” allowing the project access to tax-exempt “governmental use”

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<sup>4</sup> Pennsylvania Department of Transportation, “CNG Fueling Stations Project: Implementation Timeline,” March 28, 2016.

<sup>5</sup> Pennsylvania Department of Transportation, “CNG Fueling Stations for Transit Agencies Public-Private Partnership Project,” March 28, 2016.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> University of California, Merced, “2020 Project,” accessed May 4, 2016.

<sup>10</sup> The State Street Redevelopment Project, “About,” Accessed on May 4, 2016.

bonds.<sup>11</sup> This innovative deal structure earned KentuckyWired the Bond Buyer's 2015 "Deal of the Year" award as the first ever non-transportation P3 to use tax-exempt bonds.<sup>12</sup> Further, the principal on these fixed-rate bonds amortizes quarterly, which reduces annual interest expenses – another first for a P3 deal.<sup>13</sup>

Other projects of note include the Michigan Freeway Lighting P3 and the Pennsylvania Rapid Bridge Replacement Project. The Michigan freeway lighting project, which closed in August 2015, was the first P3 in the United States to reach initial financial close using private placement debt.<sup>14</sup> This is significant, because it signals that for the first time private credit markets are sufficiently confident in a public works project's value that they are willing to underwrite the risk themselves. The Pennsylvania Rapid Bridge Replacement Project, which will replace 558 aging bridges on smaller state highways and in rural areas across the state, is also unique.<sup>15</sup> This is the first time a P3 that bundles multiple projects together has reached financial close in the U.S.<sup>16</sup>

## Conclusion

Despite getting off to a slow start in the U.S., P3s have emerged as a cost effective approach to funding public infrastructure. As P3 use evolves into new areas, like social infrastructure, they create new opportunities for government at every level to provide their citizenry with more and perhaps better services at lower costs. Further, as P3 financing models evolve and private equity and debt providers become more confident in seeing a return on investment, the U.S. could begin to see the type of infrastructure growth and expansion it has been clamoring for. There is no silver bullet to modernizing all U.S. infrastructure, but innovation in the P3 marketplace adds a timely and needed tool to the infrastructure finding tool box.

***The Alliance for Innovation and Infrastructure (Aii)** consists of two non-profit organizations, The National Infrastructure Safety Foundation (NISF) a 501(c)(4), and the Public Institute for Facility Safety (PIFS) a 501(c)(3). The Foundation and the Institute focus on non-partisan policy issues and are governed by separate volunteer boards working in conjunction with the Alliance's own volunteer Advisory Council.*

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<sup>11</sup> Squire Patton Boggs, LLP, "Market Update: A Review of Recent Activity in the U.S. Public Private Partnership (P3) Sector and the Outlook for the Year to Come," March 3, 2016.

<sup>12</sup> Kentucky Finance and Administration Cabinet, "Broadband Kentucky," accessed on May 5, 2016.

<sup>13</sup> Ibid.

<sup>14</sup> Squire Patton Boggs, LLP, "Market Update: A Review of Recent Activity in the U.S. Public Private Partnership (P3) Sector and the Outlook for the Year to Come," March 3, 2016.

<sup>15</sup> Plenary Walsh Keystone Partners, "What is the Pennsylvania RBR Project?," accessed May 5, 2016.

<sup>16</sup> Squire Patton Boggs, LLP, "Market Update: A Review of Recent Activity in the U.S. Public Private Partnership (P3) Sector and the Outlook for the Year to Come," March 3, 2016.