

Beyond P3s – Towards ‘Public Impact Partnerships’ for Basic Infrastructure

Preliminary Concepts Outline
May 2019

1. Deferred maintenance and delayed investment of basic public infrastructure is the real challenge

- a) ‘Kicking the can’ on necessary infrastructure is an expensive form of off-balance sheet debt
- b) ‘Refinancing’ this obligation with cost-effective techniques and low-cost debt will have high and certain benefits
- c) Almost all US states and localities have the resources and the credit rating to do this now

2. If the benefits are so high and the resources are there, why isn’t something happening?

- a) New approaches are needed -- the scale of the challenge is often beyond traditional procurement processes and ‘fiscal constraints’ such as statutory bond limits and balanced budget requirements can impose arbitrary limits on borrowing.
- b) Basic infrastructure is simply not very exciting – hard to develop a consensus to fix it until condition is very bad, which is most costly (and dangerous) path

3. P3s seemed to offer a combination of new approaches and consensus-building excitement. But the reality to date has been disappointing and the P3 ‘brand’ is increasingly in disfavor.

- a) Most P3-type new approaches to construction, O&M and structured debt financing are in fact considered valid and increasingly labelled ‘Alternative’ procurement and financing techniques. WIRFC summarized these approaches in the ‘New Alternative Framework’
- b) But P3 *excitement* was based on the idea that private-sector partnerships were so transformational as to deliver a ‘free lunch’. This idea, unfortunately encouraged by the P3 industry itself, was never realistic or

sustainable – even less so in the post-2008 world where 1990s faith in private-sector market solutions seems increasingly outdated and invalid.

4. Could Impact investment be a catalyst for public infrastructure that's suited to the times?

- a) New Alternative procurement and financing approaches are necessary – but not sufficient.
- b) A *catalyst* to spark consensus-building excitement is needed. The catalyst should reflect, not private-sector 'magical free lunch', but current community concerns -- local employment, infrastructure access, climate change and environmental quality. Basic infrastructure projects could be enhanced with additional physical or social assets to address these concerns.
- c) In general, while the additional physical and social assets are 'public goods' that should be *funded* from the same public-sector sources used for the basic assets (e.g. taxes, local rates), the catalytic assets could be specifically *financed* by ESG-oriented Impact investors who can (1) provide *synergies* with expertise in developing and monitoring ESG-type physical and social assets and (2) expand the *catalytic* role of the assets by validation and credible, high-visibility publicity.

5. Impact investors and public-sector agencies have more basis for a 'partnership' than in P3s

- a) While Impact investors are generally private-sector entities who can bring market investment skills to bear, by definition they seek objectives that are not solely profit-maximizing and are generally aligned with public-sector obligations to the community – shared objectives are the basis for a real partnership.
- b) For the basic infrastructure assets of a project, the public-sector agencies can efficiently utilize private-sector capabilities through contracts – no 'partnership' is necessary. This is general perspective of the New Alternative Framework.
- c) For the additional physical assets (e.g. enhanced climate-change resilience, innovative green tech) and especially the social assets (e.g. workforce development and affordability/accessibility programs), specialized skills,

less measurable outcomes and broad consensus-building are involved – public-sector agencies could benefit from a partnership approach with ESG investor in these complex and innovative areas.

- d) Specifically, and most importantly, both the public sector and the ESG investors have a shared goal to catalyze a public infrastructure project – not for profit-maximization, but for public benefit. This is the essence of a ‘Public Impact Partnership’.

6. What will a rigorous benefit-cost analysis of an enhanced public infrastructure project with a Public Impact Partnership look like? Is this another P3-type ‘free lunch’ story?

- a) As noted above, the PV benefits of remediating deferred maintenance and delayed investment for basic public infrastructure are generally high and relatively certain if efficient Alternative techniques and low-cost debt are used. In effect, it is the benefit of refinancing an expensive obligation (e.g. accruing at 8% per year if inefficiencies and failure risk are included) with cheaper O&M and financing (e.g. costing 5% per year) – in a 30-year timeframe, the benefits are significant, measurable and relatively locked-in.
- b) In contrast, the PV benefits of additional non-basic physical and social assets may be low and highly speculative as dependent on uncontrollable macro factors (e.g. long-term economic growth, realized rate of climate change). The probability and value of outcomes are in any case extremely hard to measure. The PV benefits should be assumed at zero and the BCA result equals the cost.
- c) Two general BCA cases should be considered. The first, a downside case, should assume that the Public Impact Partnership has *no catalytic value* (i.e. the project would have proceeded at the same time with or without the Partnership). In this case, the PV benefit of the basic asset remediation simply subsidizes the non-basic physical and social assets. This outcome may be acceptable if it reflects community preferences as to resource allocation – in effect, the basic asset PV benefit is ‘recycled’ into other assets the community wanted anyway (and perhaps with synergistic and transactional efficiencies).
- d) The second, upside case should assume that the Public Impact Partnership does have a catalytic effect in terms of *accelerating the remediation of the basic infrastructure assets*, as measured in time units (e.g. years). In this

case, the Partnership will have caused the realization of the basic asset remediation benefits (including avoided further costs of 'kicking the can' accruals) sooner than otherwise and the PV of benefits is increased.

Depending on the acceleration (a few years at least?) and the relative scale of basic asset remediation benefit PV compared to the cost of non-basic and social assets (basic assets likely much larger?), the catalytic effect of the Partnership might realistically pay for the enhanced infrastructure. The specific choice of non-basic physical and social assets with respect to cost could be based on trying to achieve this 'self-pay' outcome.

- e) Important point here: regardless of the potential popularity among some stakeholders of enhanced public infrastructure, the development of a Public Impact Partnership concept should, from the outset, rely on rigorous and realistic BCA and strenuously avoid any suggestion that a free lunch is involved. The history of P3 overpromising and backlash should be seen as a cautionary tale.