

# In U.S., a Hot Debate on Infrastructure Privatizing

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By James B. Kelleher

CHICAGO, March 20 (Reuters) - As they struggle to close ballooning budget deficits amid the worst financial crisis since the Great Depression, many U.S. state and local governments will be tempted to follow the example of Chicago.

The third-largest U.S. city has raised billions of dollars in recent years turning public assets over to private businesses that then run them as for-profit enterprises.

The early success of those transactions, as well as a much longer track record overseas, has stoked an interest in these "public-private partnerships" -- or P3s for short.

So, too, has the growth of funds focused on P3 investing. In recent years, they've raised money from pension funds and other big investors faster than assets have hit the market, creating a demand for deals that has only gained strength as Wall Street melted down and triggered a flight to safety.

"These things give investors steady earnings over a long period of time," said James McKinney, head of debt capital markets at William Blair & Co, a lead adviser to Chicago when the city leased 36,000 parking meters to a private consortium.

But critics warn the push to lease toll roads, airports, parking meters and other public assets to corporate concessionaires is not the painless panacea backers claim.

They say the deals, especially when asset values are depressed across the board, are myopic moves that elevate private profit over public good, entail long-term costs and risks, and could trigger a financial crisis of their own.

"The devil is in the details -- as future generations to come will learn," said Pat Andrews, editor of Alltoll.com, a Web site dedicated to preventing more highway privatizations in the state of Indiana, another pioneer of such transactions.

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"That's the most irritating thing about this -- the sheer shortsightedness of it. It's money now and who the hell cares about three generations from now. And that's not right."

But backers say a reluctance to tax, coupled with chronic underinvestment in public services

for decades, has left many city and state financial managers little choice.

"There needs to be an introduction of private sector capital to help deal with the legacy of underinvestment and, frankly, undercharging for infrastructure that has gone on in this country for a very long time," said Tom Osborne, head of Americas Infrastructure/Privatization at UBS.

But McKinney at William Blair & Co admits the current downturn is focusing policy-makers' minds.

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"There are a lot of municipalities that are suddenly open to discussions on the topic, that's for sure," McKinney said.

EYE-POPPING MULTIPLES

In the deal William Blair brokered last year, a Morgan Stanley infrastructure investment fund paid Chicago nearly \$1.2 billion up front to operate the parking meters for 75 years -- or more than 60 times the system's annual operating profit of about \$19 million.

That eye-popping multiple generated lots of buzz and interest among cash-strapped municipal officials nationwide.

"We've got guys marketing coast to coast right now, talking to people, introducing them to the concept, and going through the math on it and the economics of it," McKinney said.

Adding to the P3 push: Massive liquidity sitting on the sidelines. In recent years, billions of dollars have flooded into so-called infrastructure investment funds.

But with so much interest and so much money at stake, it's no surprise that public asset privatization has sharp critics.

Indeed, an effort by the state of Pennsylvania last year to lease its turnpike to private investors came to nothing amid legislative opposition to the plan.

Elliot Sclar, a professor at Columbia University in New York, sees the P3s as just the latest product Wall Street bankers have dreamt up to make a buck - and one taxpayers will pay to clean up.

"Just watch," Sclar said. "This is going to be the subprime mortgage scandal for the next generation."

With too much money chasing too few good deals, Sclar says, the transactions will get riskier. When a private operator eventually hits trouble, states and municipalities that saw the long-term leases as free money will find themselves involved in complex and costly litigation and unknown liabilities.

But opponents also include bankers like Dennis Enright, a principal at NW Financial Group, a regional investment banking group in New Jersey involved in municipal underwriting.

Enright's objection is simple and compelling.

If private investment funds are willing to buy the bonded debt of a decaying road like the Chicago Skyway based on the expected cash it will generate over the next 99 years, then doesn't it makes more sense --- from a strictly financial standpoint -- for government to do the deal itself?

By including private concessionaires, Enright says, states and municipalities are essentially leaving billions of dollars on the table and subjecting users and taxpayers to higher costs - and greater risks - down the road.

"What we tried to bring to it was some rational analysis to this," he said. "It was curiosity that drove us to analyze them and when we did the math we said: 'Oh my God, this is crazy.'"

Enright says he's also concerned about the length of the concession periods involved in U.S. deals. Although backers of the deals often point to the long track record of P3 success in Europe, South America and Asia, there are some significant differences. In almost all the overseas deals, the assets were roads newly built by the concessionaire, not existing ones originally built by the public. And concession period was typically much shorter and usually no more than 30 years.

Osborne at UBS acknowledged that tax-exempt municipal bonds are a cheaper way to raise money than the equity and corporate debt private firms rely on. But like all the bankers involved in the deals, he said the bottom line is more complex.

"You can't look at these things purely on a financing cost basis," he said. "You need to look at whole-of-life project cost," including

maintenance costs and the quality of service over the decades-long life of the project.

Critics remain unconvinced.

"If the public's going to have to pay higher tolls, it doesn't really matter as a driver whether you're paying it to a public entity or a private entity," said Kerry Korpi, an official with the American Federation of State, County and Municipal Employees union.

"If that's the bullet that has to be bit, it ought to be the public sector that's biting it and enjoying the income stream."

(Editing by Peter Bohan and Doina Chiacu)

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